

CALIFORNIA LIMITED LIABILITY COMPANY REVIEW

DELAWARE VS. CALIFORNIA

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Anyone forming a legal entity must consider under what jurisdiction to form the entity.

In California, the decision often distills to deciding between forming a Delaware LLC or a California LLC. This article reviews some of the considerations.

One basic consideration relates to the members. Members and their advisors often already have familiarity with Delaware or California LLCs. The members could achieve significant formation and operational savings in not changing the jurisdiction and underlying documentation. "If it is not broken, why fix it." Conversely, if members reside in different states, the advisors of some of the members may have significantly more familiarity with the "Delaware Act" (Del. Code Ann. tit. 6, ch. 18) than with the "California Act" (Cal Corp. Code sec. 17000 *et seq.*). **BEGINNING IN 2014, THE CALIFORNIA ACT IS REPEALED. LOOK FOR MY WEBSITE ARTICLES ON THE NEW RULLCA PROVISIONS.**

Another basic consideration relates to the planned activities of the LLC. If the LLC will engage in activities in states outside of California, then customers, suppliers, regulators, landlords and other dealing with the LLC in

those states may have more comfort dealing with a Delaware LLC. Some third parties, such as lenders, may have a policy of only lending to a Delaware LLC.

A third basic consideration relates to differences in the underlying law. Many believe that Delaware courts will settle important LLC legal issues before other jurisdictions and with a more business friendly result.

There are significant differences in the underlying LLC laws of Delaware and California that favor management. Section 18-1101 of the Delaware Act allows the parties to essentially eliminate fiduciary duties of members and managers. In California, a reduction in the fiduciary duties of loyalty and care of managers must be in a written operating agreement and with informed consent, which could pose problems. Additionally, Section 18-407 of the Delaware Act expressly sanctions broad delegation of authority by managers to third parties. California merely states that managers owe fiduciary duties to the LLC and its members as those of a partner in a partnership, which could limit the ability of a manager to broadly delegate duties.

The Delaware Act provides an overall greater freedom of the members to contract with

respect to their rights, privileges, obligations, and duties. Section 17005 of the California Act limits the rights of the parties to vary certain provisions. For instance, members of a California LLC must have the right to vote on a dissolution, merger or amendment to the articles.

The California Act provides many more default provisions than the Delaware Act, which can create problems for a Delaware LLC if the operating agreement does not address the issue. For instance, Section 17104 of California Act provides detailed meeting, voting and approval provisions, whereas Section 18-302 of the Delaware Act generally relies upon the operating agreement.

Differences in inspection rights and rights of creditors of LLC members, may favor Delaware. "Alter ego" liability differences may favor California. There are simply too many differences between the Delaware Act and California Act to address them all in this article.

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