

CALIFORNIA RULLCA REVIEW

Membership and Transferable Interests

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The California Revised Uniform Limited Liability Company Act (RULLCA; 2012 Ch. 419 [SB 323])), codified at Section 17701.01 *et seq.* of the California Corporations Code (repealed or in effect, the Code), repealed in its entirety the Beverly-Killea LLC Act (the Old Act) effective January 1, 2014.

Many provisions that relate to membership interests remain the same under RULLCA as under the Old Act. For instance, (i) a membership interest is personal property and not an interest in the LLCs underlying assets, (ii) an LLC can issue certificates evidencing a membership interest, and (iii) an LLC can have various classes of membership interests, but not “Series.” (Compare Sections 17300, 17105 and 17102 with Sections 17705.01, 17705.02(d), and 17712.01 of the Code.)

However, RULLCA uses the terms “transferable interest” and “transferee” in place of the terms “economic interest” and “assignee” used in the Old Act. (Compare Section 17001(n) with Section 17701.02(aa) of the Code.) Accordingly, a “membership interest” under RULLCA includes a transferable interest and rights to vote, participate in management and receive information, rather than referring to an

“economic interest.” A transferee holding a transferable interest generally has rights only to receive distributions from the LLC and not rights to vote, participate in management or inspect LLC records to the extent of a member. Future legislation may clarify the extent of a transferee’s inspection rights. (Sections 17705.02 and 17704.10(a) of the Code.) Although an economic interest is similar to a transferable interest, operating agreements drafted under RULLCA should use the new terminology.

RULLCA makes some substantive changes. RULLCA makes clear that a member does not need to hold a transferable interest or make a contribution of capital or services to an LLC to be a member. (Section 17704.02(d) of the Code.) In other words, a member can be a non-economic member, which could allow certain persons to vote on matters to break deadlocks, bankruptcy, dissolution and similar matters even though those persons have no economic stake in the LLC as a member. A non-economic member probably should not be considered a partner for income tax purposes.

RULLCA also contains provisions relating to a transferee that are not expressly set forth in the Old Act. Among others, those include the following: (i) the

obligations of an LLC and its members to a transferee are governed by the operating agreement, (ii) an operating agreement can be amended without the consent of a transferee even though the amendment may adversely affect the transferee, (iii) a transfer of all of a member’s transferable interest could lead to an expulsion of the member from the LLC, and (iv) a transfer in violation of the operating agreement is ineffective for a person who has notice of the restriction at the time of the transfer. (Sections 17701.12(b), 17706.02(d) and 17705.02 of the Code.)

As under the Old Act, RULLCA allows the operating agreement to place restrictions on transfers. Therefore, the operating agreement should provide rules regarding permitted transfers, rights of first offer or refusal, optional or mandatory buy-outs, the necessary vote for a transferee to become a member and conditions for a transfer, such as compliance or consideration of securities and tax laws.

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