

Date of Hearing: March 28, 2022

ASSEMBLY COMMITTEE ON BANKING AND FINANCE

Timothy Grayson, Chair

AB 1802 (Maienschein) – As Introduced February 7, 2022

**SUBJECT:** Limited liability companies

**SUMMARY:** Specifies that assets omitted from the winding up of a limited liability company (LLC) will be used to discharge unsatisfied liabilities before being distributed to members.

Specifically, **this bill:**

- 1) Requires any assets inadvertently or otherwise omitted from the LLC's winding up, upon cancellation and on realization, to be used to discharge unsatisfied liabilities, if any, known to the company, after which the excess must be distributed to the members.
- 2) Authorizes any person who is authorized to wind up the affairs of an LLC that has filed a certificate of cancellation to use the omitted assets to discharge the liabilities of the LLC and to distribute to the members of the excess assets.
- 3) Makes assorted technical changes.

**EXISTING LAW:**

- 1) Establishes the California Revised Uniform Limited Liability Company Act, which governs all California LLCs. (Corporations Code, Sections 17701.01-17713.13).
- 2) Establishes procedures for the winding up of an LLC, including specifying that the persons winding up the affairs of the LLC must provide written notice of the commencement of the winding up by mail to all known creditors and claimants (Corp Code Sec. 17707.04) and establishing the prioritization of how remaining assets may be distributed to members once all known debts and liabilities have been paid or adequately provide for (Corp Code Sec. 17707.05).
- 3) Specifies that an LLC that has filed a certificate of cancellation continues to exist for the purpose of winding up its affairs, prosecuting and defending actions by or against it in order to collect and discharge obligations, disposing of and conveying its property and collecting and dividing its assets. Any assets inadvertently or otherwise omitted from the winding up continue in the canceled LLC for the benefit of the persons entitled to those assets upon cancellation and on realization must be distributed accordingly (Corp Code Sec. 17707.06).

**FISCAL EFFECT:** Unknown. This bill is keyed Fiscal by Legislative Counsel.

**COMMENTS:**

- 1) **Purpose.**

According to the author:

AB 1802 is an important bill to ensure that it is clear about who may act on behalf of a dissolved LLC and how the dissolved LLC may distribute or transfer omitted or retained assets.

This bill is sponsored by the California Lawyers Association, who states that this bill will help “avoid unnecessary legal actions that may otherwise be required to address the right to transfer of property retained in a cancelled LLC.”

## 2) **Background.**

An LLC is a hybrid between a corporation and a partnership. An LLC generally has the beneficial characteristics of a partnership for operational and taxation purposes, but its members enjoy the immunity provided by a corporation to its shareholders for contract debts or tort liability. Regulation of LLCs varies by state, and the California Revised Uniform Limited Liability Company Act (RULLCA) governs LLCs registered in California. Among its many provisions, RULLCA includes default provisions in LLC operating agreements and provides a breadth of default rules that apply to LLCs in situations where an operating agreement is silent on a particular issue. RULLCA is based on model legislation adopted by the National conference of Commissioners on Uniform State Laws, which aligns it with legislation in other states and makes it easier for businesses to operate across state lines.

When an LLC wants to cease operations and close down, typically it will go through a dissolution process through which the LLC winds up its financial and legal affair. An LLC’s dissolution can be an extensive process that requires the business to cease its business operations, pay off debts and other financial obligations, and liquidate its assets. Any surplus then gets distributed to members.

In many cases, an LLC’s members voluntarily trigger dissolution by a vote, and the LLC’s operating agreement defines the specifics of the LLC’s dissolution. But, as noted above, RULLCA also provides for default processes and standards to ensure that an LLC’s dissolution is orderly and fair. For example, RULLCA establishes the prioritization of how the LLC’s surplus assets may be distributed to members and defines how to determinate if a payment of a debt or obligation has been adequately provided for.

Once the LLC completes the winding up process, the LLC then proceeds to formal cancellation, which involves working with the Secretary of State (SOS) to terminate the dissolved LLC’s rights, privileges and powers.<sup>1</sup>

The ease at which an LLC can go through dissolution and cancellation depends on its management and legal arrangements, whether there is a consensus among the LLC’s owners, and its financial health and the nature of its assets and liabilities, among other factors. For example, if there is unanimous agreement among the members to wind up the LLC’s affairs, which is unlikely unless all affairs were resolved satisfactorily, then the LLC can proceed immediately to filing a certificate of cancellation with SOS.

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<sup>1</sup> See description of the available cancellation forms <https://bpd.cdn.sos.ca.gov/llc/forms/llc-3--4-7.pdf>

**3) What does this bill do?**

This bill clarifies what should happen in the event that assets are inadvertently omitted during the LLC's dissolution process. While this is not a common occurrence, the complicated nature of dissolution can lead to those managing the process to miss certain assets, such as a trademark or rights in real property that are not material.

When assets are omitted in an LLC's wind up process and then discovered, current law is vague on how those omitted asset should be distributed and who is authorized to distribute them. AB 1802 clarifies that these omitted assets must first be used to discharge any known unsatisfied liabilities, after which the excess can then be distributed to the LLC's members.

**4) Related legislation.**

AB 506 (Maienschein), Chapter 775, Statutes of 2015. Makes assorted changes to the California Revised Uniform Limited Liability Company Act (RULLCA) and the California Revised Uniform Limited Partnership Act of 2008 (RULPA)

**REGISTERED SUPPORT / OPPOSITION:**

**Support**

California Lawyer's Association (Sponsor).

**Opposition**

None on file.

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