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California llc operating agreement requirements

California LLC members will use this agreement to formally name their company tax status, the membership roster, the company's business activity, and the rules that govern it. Voting Procedures The operating agreement should establish clear voting procedures to govern business decisions and prevent conflicts. Is an Operating Agreement Required to Form a California LLC? Compensation and removal of managers must also be addressed. Without a written operating agreement, default statutory rules apply. Some agreements include provisions requiring the LLC to distribute enough funds to cover members' estimated tax liabilities, preventing financial burdens. Your LLC name must also be unique, so that it's distinguishable from the names of other LLCs registered in the state. While the agreement can define voting rights and decision-making processes, it cannot override statutory provisions requiring unanimous member consent for fundamental actions like amending the agreement or dissolving the LLC, as stated in 17704.07. Download: Adobe PDF, MS Word State Definition CA Corp Code § 17701.02 (s) (2019) ""Operating agreement" means the agreement, whether or not referred to as an operating agreement and whether oral, in a record, implied, or in any combination thereof, of all the members of a limited liability company, including a sole member, concerning the matters described in subdivision (a) of Section 17701.10. Under California's registered agent rules, you or another LLC member can serve as your LLC's registered agent, but this can be an inconvenient option. Proper identification is crucial for determining voting rights, financial distributions, and liability protections. The California Revised Uniform Limited Liability Company Act is the principal law governing LLCs in California. This protects the company from bearing financial responsibility for unlawful or reckless actions. Quorum requirements should be specified to prevent a small minority from making binding decisions without broader participation. Without these safeguards, an LLC may be forced to accept an unwanted or unqualified member, disrupting operations and decision-making. A member's spouse or heirs may acquire an interest in an LLC as a result of the member's death or divorce. Your LLC name can't contain words that might mislead people into thinking your business is a corporation or an insurer, or that your business is affiliated with a government authority. California law allows amendments as long as they follow the procedures established in the agreement. An operating agreement lets members take advantage of the LLC structure's legal benefits and flexibility and limit members' potential risk exposure. Record-keeping obligations must also be addressed. Will each vote have equal power, or will voting power be determined by membership interests? Equity classes. Under RULLCA, voting power depends on membership interest and amending Articles of Organization or the Operating Agreement requires a unanimous vote. Allocation of Losses Loss allocation must be clearly defined to prevent financial disputes and tax complications. A California LLC's operating agreement commonly records the members' decisions about any or all of these important matters: Management structure. In practice, these broad categories can include a multitude of subjects, and California law gives LLC owners considerable flexibility to create an operating agreement tailored to their specific company. Transfer of Membership Interests Transferring membership interests requires careful planning to prevent unintended ownership changes and disputes. If an LLC does not specify its management structure, it defaults to member-managed under California law. Members can take advantage of the flexibility by adopting a customized operating agreement. Usually, winding down requires a unanimous vote, but you can specify a different procedure in your Operating Agreement if you wish. Under 17706.02, a member may assign their economic rights to another party, but this does not automatically confer management or voting rights unless explicitly authorized in the operating agreement or approved by remaining members. If members fail to adopt an operating agreement—or if their operating agreement is silent on an issue—California has numerous default rules to fill the gap. Distributions of Profits California law allows LLC members to determine how profits are distributed. At the minimum, your California LLC Operating Agreement should cover the following: Organization / Formation Most LLC Operating Agreements open by recording basic information about your LLC, like its name, purpose, business address, California registered agent information, and the names of all members. Without clear transfer provisions, an LLC may face legal challenges if a departing member attempts to sell their interest to an outside party. This may not be suitable for companies with passive investors or those preferring centralized management. However, we've highlighted a handful that we think are important to address in your Operating Agreement. The agreement should clarify managerial powers, appointment and removal procedures, fiduciary duties, and any compensation or reimbursement terms. Mandatory Clauses Under State Law California law does not require an LLC to have an operating agreement, but if one exists, it must comply with the California Revised Uniform Limited Liability Company Act (RULLCA), codified in the California Corporations Code 17701.01–17713.13. California law does not provide a statutory mechanism for resolving deadlocks, so without these provisions, members may be forced to seek costly judicial intervention. An operating agreement should include customized fiduciary duty provisions that clarify the duties that members and/or managers owe to the LLC. Alternative dissolution triggers can include the expiration of a predetermined business term, insolvency, or the withdrawal of a key member. The agreement should also address how losses impact members' capital accounts. Signatures Lastly, make sure all members sign your Operating Agreement. Unlike a regular agent, a registered agent's sole function is to accept the delivery of important legal or government documents for your business, such as service of process. Whether you're starting with a short list of alternatives, or have a particular name in mind, make sure the name you choose complies with California's requirements for LLC names: Your LLC name must clearly indicate that it's a limited liability company. A California LLC cannot use its operating agreement to modify or override any non-waivable provisions listed in California law. This agreement may be oral or written; however, in order to clearly demonstrate its legitimacy, a limited liability company should have a written and signed agreement that has been fully researched and executed by its members. Developing a gameplan for addressing potential issues early helps the business navigate future complications with minimal disruption. Without these provisions, members may struggle to reach a consensus on winding down the company, leading to legal disputes. In a manager-managed LLC, the agreement should specify the scope of authority granted to managers, including their ability to enter contracts, hire employees, and control financial accounts. As we all know, disputes over money can be long and bitter. Dissolution Here, you'll outline the steps needed to dissolve or "wind down" your California LLC. This act greatly expanded California's so-called "default rules." If your Operating Agreement is silent on certain issues, your LLC will be governed by California's default provisions. What will you do if one of your members goes bankrupt, becomes incarcerated, or— heaven forbid—dies? Other members may want to avoid a situation where they find themselves in business with a member's ex-spouse or heir who is unfamiliar with the company. A well-defined amendment process ensures transparency and adaptability while protecting members' interests. Click on the state below to get started. If additional contributions are required, the document should detail the circumstances triggering payments, how each member's share is determined, and consequences for failing to contribute. This means that your LLC could someday be controlled by members you never approved. An operating agreement should establish agreed rules for when and how members may transfer their ownership interests in the California LLC. Without a written agreement, state default laws govern the LLC, which may not align with the owners' intentions. The operating agreement should include mechanisms to resolve deadlocks, such as mediation, arbitration, appointing a neutral third-party tie-breaker, or implementing a buyout provision where one member can purchase another's interest in the event of an irreconcilable dispute. Once dissolution is initiated, the LLC must file a Certificate of Cancellation with the California Secretary of State. Without clear provisions, disagreements over voting power and approval requirements can lead to internal disputes, stalling business operations or resulting in litigation. The term "operating agreement" may include, without more, an agreement of all members to organize a limited liability company pursuant to this title. What you include in your California Operating Agreement will depend on how you want to run your LLC. If left unspecified, disputes may arise between members who prefer to withdraw earnings and those advocating reinvestment. Membership Changes and Transfers This is where you need to think ahead a little. Unlike corporate officers who receive salaries, LLC managers may be compensated through management fees, profit-sharing, or other financial arrangements. Under California law, new members are deemed to have consented to the operating agreement when accepting membership in a company. Things change, and even close-knit business partners sometimes need to part ways. Consequences for failing to meet financial commitments, such as dilution of ownership or loss of voting rights, should also be outlined. This is one of the few issues that RULLCA doesn't provide a default provision for, so it's vital to clearly spell out how profits will be allocated. Capital Contribution This is where you'll agree on how much money (or other assets, including property or services) each member will contribute. If the name you've chosen is available, but you're not ready yet to file for your LLC, you can submit a name reservation request to the Secretary of State. Routine operational matters may be decided by a majority vote, while significant actions like amending the agreement, acquiring or selling major assets, or taking on substantial debt may require a two-thirds or unanimous vote. The following steps will walk you through how to form your LLC in California: 1. Does every member have voting rights? Some agreements impose dilution provisions, reducing ownership for members who do not meet their obligations, while others allow external financing or new members to raise capital. An operating agreement is like the LLC's constitution—customizing the company's management structure and affairs to the members' preferences and business plan. Several registered agent companies operate in California, so if you elect to go this route, it's a good idea to do your research and compare both pricing and features of competing companies to find one that's right for your business. Dissolution Procedures When an LLC ceases operations, its dissolution must follow legal and procedural steps to ensure compliance and prevent future liabilities. This section should also address future capital calls—whether additional funding is required and how it will be allocated. A California LLC's operating agreement cannot do any of the following: Vary the LLC's capacity to sue and be sued in its own name; Declare that the laws of a state other than California govern the LLC's internal affairs, member or manager liability for the LLC's obligations, or members' or agents' authority; Limit a court's power to order a person required to sign and deliver a record to the California Secretary of State to do so; Eliminate the duty of loyalty, the duty of care, or any other fiduciary duty except as expressly permitted by the California LLC Act; Eliminate the contractual obligation of good faith and fair dealing except as expressly permitted by the California LLC Act though an operating agreement may adopt standards for measuring the performance of the obligation; Vary the provisions of the California LLC Act that govern registered agents and foreign limited liability companies; Vary a court's power to decree dissolution of an LLC or the provisions allowing a company to avoid dissolution; Vary the requirements relating to the formation, dissolution, or winding-up of an LLC; Unreasonably restrict a member's right to maintain a class action on behalf of other members; Restrict a member's right to approve a merger or conversion if the member will have personal liability with respect to the surviving or converted organization; Restrict rights under the California LLC Act of a person other than a member or manager—except that an LLC's obligations to a transferee or dissociated member are governed by the operating agreement; Vary any provisions relating to mergers and conversions unless expressly permitted under the California LLC Act's provisions governing mergers and conversions; Vary any provision of Article 11 (governing dissenter's rights), Article 12 (allowing the articles of organization or operating agreement to create classes of interests), or Article 13 (miscellaneous provisions relating to application, construction, administration, and procedure); Eliminate the duty of loyalty—except that an operating agreement may (i) identify activities that do not violate the duty of loyalty or (ii) specify member approval needed to authorize an act or transaction that would otherwise violate the duty of loyalty; Unreasonably reduce the duty of care. This usually determines membership interest. The agreement should define how often profits are distributed—whether quarterly, annually, or on an as-needed basis—and whether distributions are mandatory or subject to managerial discretion. If an operating agreement lacks detailed dissolution provisions, disputes may arise over asset allocation, creditor payments, and final tax obligations. For example, an Operating Agreement might specify that membership transfers be decided by a unanimous or simple majority vote. If you want some say over how membership is transferred, it's important to specify your arrangement in your Operating Agreement. If the agreement does not specify, profits are allocated based on ownership percentage. Beyond voting thresholds, the agreement should define how votes are conducted—whether through formal meetings, electronic or written ballots, or proxy voting. The operating agreement should specify the members' economic rights—including profit and loss allocation and rights to distributions—and how factors like additional contributions may affect economic rights in the future. Deadlocks in voting can create serious challenges, particularly in LLCs with an even number of members or equal ownership stakes. We're not lawyers, so we can't speak with authority on the implications of each default provision. However, members can agree to a different distribution structure as long as it is documented. What Issues Do California Operating Agreements Address? LLC ownership—called membership interest—is usually represented by a percentage. Some agreements implement right of first refusal clauses, granting current members the opportunity to purchase the departing member's interest before it is offered externally. If so, you'll need to set the rules. Advance planning through a well-thought-out operating agreement helps ensure the LLC's smooth management and operations in the future. Managers owe fiduciary duties of loyalty and care to the LLC and its members under 17704.07, requiring them to act in the company's best interest and avoid conflicts of interest. Under 17704.08, an LLC may indemnify members and managers against liabilities incurred in business operations but cannot do so for acts involving fraud, gross negligence, or willful misconduct. An LLC's other key governing document—the California articles of organization—officially creates the company and registers it in the California Secretary of State's records but does little else to structure the company. If a California LLC has multiple classes of ownership interests that differ in either economic or voting rights (this is not required), the equity classes should be created and clearly defined in the operating agreement. An operating agreement of a limited liability company having only one member shall not be unenforceable by reason of there being only one person who is a party to the operating agreement. 3. Without the signature of each member, the Operating Agreement can be difficult to enforce. Indemnification is another key provision. Unless specified otherwise, LLC decisions default to majority approval based on ownership percentage. The agreement should specify which decisions require a simple majority, supermajority, or unanimous consent. Provisions for member death or divorce. Other issues are automatically decided by a simple majority vote. The agreement may also stipulate that unresolved disputes trigger dissolution or buyout options, ensuring business continuity. While it is not technically mandatory for a California LLC to have a written operating agreement, proceeding without one is unwise. It's important to get this part down in writing because if you don't specify these contributions in your Operating Agreement, members are not legally obligated to contribute anything (even if they said they would). The agreement should also clarify whether additional capital contributions are mandatory or voluntary. A well-documented dissolution process ensures a smooth wind-down and protects members from legal and financial complications. Voting Rights Will your LLC make major decisions—like whether to allow a transfer of membership interest or dissolve your company—by vote? Identification of Members The operating agreement should explicitly list all individuals or entities with an ownership interest in the LLC. The operating agreement should outline conditions for dissolution, such as a unanimous vote, a key member's departure, or an event specified in the agreement. 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