

SENATE JUDICIARY COMMITTEE
Senator Thomas Umberg, Chair
2021-2022 Regular Session

AB 1802 (Maienschein)
Version: February 7, 2022
Hearing Date: May 31, 2022
Fiscal: No
Urgency: No
AWM

SUBJECT

Limited liability companies

DIGEST

This bill clarifies that a dissolved limited liability company's (LLC) assets omitted from the LLC's winding up must be used to discharge the LLC's unsatisfied liabilities before being distributed to members.

EXECUTIVE SUMMARY

The California Revised Uniform Limited Liability Company Act (the Act) governs all LLCs formed in California. The Act provides requirements for how an LLC may be formed and also for how an LLC may be dissolved and its affairs wound up. Current law provides for how an LLC must disburse its remaining assets as part of the winding up: first to satisfy any debts or liabilities, and then, if any assets remain, it may be distributed out to the members. Current law also provides, albeit vaguely, for how the assets of an already-dissolved LLC must be distributed if the assets are discovered after dissolution, stating that "assets inadvertently or otherwise omitted from the winding up continue in the canceled limited liability company for the benefit of the persons entitled to those assets upon cancellation and on realization shall be distributed accordingly."

This bill would clarify how a former LLC's assets, discovered post-dissolution, should be distributed by making clear that any assets omitted from disbursement during the winding up are subject to the same requirements as the LLC's other assets: the newly discovered assets must first be used to discharge the LLC's liabilities, if any; once the liabilities are satisfied, any remaining assets may be distributed to the members. The bill also provides that any person authorized to conduct the LLC's winding up may distribute the assets accordingly.

This bill is sponsored by the Partnerships and Limited Liability Companies Committee of the Business Law Section of the California Lawyers Association. There is no known opposition.

PROPOSED CHANGES TO THE LAW

Existing law:

- 1) Establishes the California Revised Uniform Limited Liability Company Act, which governs the formation and regulation of limited liability companies in this state. (Corp. Code, tit. 2.6, §§ 17701.01 et seq.)
- 2) Provides procedures and requirements by which an LLC can be dissolved and its activities wound up. (Corp. Code, §§ 17707.01-17709.09.)
- 3) Requires, as part of the winding up:
 - a) The persons winding up the affairs of the LLC to give written notice of the commencement of winding up by mail to all known creditors and claimants whose addresses appear in the records of the LLC. (Corp. Code, § 17707.04(a).)
 - b) The LLC to determine all of its known debts and liabilities and pay or provide those debts before distributing the LLC's remaining assets among the members. (Corp. Code, § 17707.05.)
- 4) Provides that an LLC that has filed a certificate of cancellation continues to exist only for the purposes of winding up its affairs, prosecuting and defending actions against it, disposing of and conveying its property, and collecting and dividing its assets. (Corp. Code, § 17707.06(a).)
- 5) Provides that any assets inadvertently or otherwise omitted from the winding up continue in the LLC for the benefit of the persons entitled to those assets upon cancellation and on realization shall be distributed accordingly. (Corp. Code, § 17707.06(c).)
- 6) Requires, upon the completion of the winding up, the persons conducting the winding up to sign and file a certificate of cancellation of articles of organization with the Secretary of State; upon the filing of a certificate of cancellation, the LLC is canceled and its powers, rights, and privileges cease. (Corp. Code, § 17707.08.)

This bill:

- 1) Modifies the provision relating to the assets of a wound-up LLC that were inadvertently or otherwise omitted from the winding up, to specify that the omitted

assets must be used to discharge unsatisfied liabilities, if any, known to the company and then any excess shall be distributed to the members.

- 2) Provides that, if any assets discovered pursuant to 1) are discovered after the filing of a certificate of cancellation, any person authorized to wind up the LLC's affairs may use the assets to discharge the LLC's unsatisfied liabilities and distribute any remaining assets to the members.
- 3) Provides that, upon the filing of a certificate of cancellation, the LLC shall be canceled except as necessary to distribute assets omitted from the winding up.

COMMENTS

1. Author's comment

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.

2. This bill clarifies how a dissolved LLC's assets should be distributed when discovered after the LLC's dissolution

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.

An LLC is not forever, however. An LLC may be dissolved by vote of 50 percent or more of the members, on the occurrence of an event that the articles of organization state will result in dissolution, or if the LLC ceases to have members for more than 90 days.¹ Once the dissolution commences, the LLC typically goes through a process in which the LLC winds up its financial and legal affairs.² The winding up requires the business to cease its business operations, pay off debts and other financial obligations, and liquidate its assets.³ Any assets remaining after the LLC's debts and liabilities are satisfied are distributed to members.⁴

¹ Corp. Code, § 17707.01.

² See *id.*, §§ 17707.04, 17707.05.

³ *Id.*, § 17707.05.

⁴ *Id.*, § 17707.05(a).

Once the winding up is complete, the person conducting the winding up files a certificate of cancellation with the Secretary of State.⁵ At that point, the LLC ceases to exist as a legal entity except for a few specified purposes – for example, if there is a legal action pending against the LLC, the LLC continues to be an entity for purposes of the suit.⁶ One other such purpose is if, after dissolution, it is discovered that any of the LLC’s assets were not included in the winding up process.⁷ Current law provides that, if it is discovered that any of the LLC’s assets were inadvertently or otherwise omitted from the winding up and therefore not distributed according to the legal order of distribution, those assets “continue in the canceled limited liability company for the benefit of the persons entitled to those assets upon cancellation and on realization shall be distributed accordingly.”⁸ In other words, the otherwise-canceled LLC is treated as if it exists for the purpose of holding onto the newly discovered assets for the persons who should have received them in the winding up process, and the persons in charge of the winding up must distribute the assets to the rightful recipients.

The language of the current law is less than pellucid. The most reasonable interpretation is that “the persons who should have received” the assets refers to the persons entitled to the assets under the statute – the LLC’s creditors or, if the LLC’s debts are satisfied, the members – but the lack of a cross-reference or other clear statement of the order of entitlement may lead to confusion. This bill seeks to eliminate this ambiguity by clarifying that any of the LLC’s assets discovered after the dissolution must first be used to discharge any of the LLC’s outstanding liabilities and then, if any assets remain, be distributed to the members. The bill also provides that the individuals who wound up the company and/or filed the certificate of cancellation may accomplish the distribution of the newly discovered assets, and makes conforming changes to other sections addressing LLC dissolution to conform them with the clarification.

3. Arguments in support

According to the bill’s sponsor, the Partnerships and Limited Liability Companies Committee of the Business Law Section of the California Lawyers Association:

This bill improves the provisions of the Revised Uniform Limited Liability Company Act (RULLCA), clarifies and eliminates a potential ambiguity or conflict of terms, and conforms to the practices for other California business entities. Specifically, AB 1802 clarifies who may act on behalf of a dissolved (canceled) limited liability company (LLC) that has filed a Certificate of

⁵ *Id.*, § 17707.08(b).

⁶ *Id.*, 17707.06.

⁷ *Id.*, § 17707.06(c).

⁸ *Ibid.* To the extent that an LLC’s assets were not inadvertently omitted from the winding up, but were instead advertently concealed, members of the LLC and/or creditors would have recourse against the party hiding the assets; those causes of action are beyond the scope of this bill, which focuses only on what the LLC must do with the assets after they were discovered, regardless of why they were omitted.

Cancellation with the Secretary of State and how the otherwise-dissolved LLC may distribute or transfer any omitted or retained assets and discharge any remaining liabilities. The bill also corrects certain cross-references with regard to related sections of the dissolution and winding-up provisions of the RULLCA. Specifically, the bill clarifies and corrects the provisions concerning the effect of the filing of a Certificate of Cancellation and authorizes the appropriate representatives of an LLC to pay over to creditors and then distribute any excess assets in the canceled LLC. The bill will also avoid unnecessary legal actions that may otherwise be required to address the right to transfer of property retained in a canceled LLC.

SUPPORT

California Lawyers Association, Business Law Section, Partnerships and Limited Liability Companies Committee (sponsor)

OPPOSITION

None known

RELATED LEGISLATION

Pending legislation: None known.

Prior legislation:

AB 1722 (Wagner, Ch. 66, Stats. 2016) authorized the dissolution of an LLC with a vote of 50 percent or more of an LLC's members instead of a majority of the members.

AB 506 (Maienschein, Ch. 775, Stats 2015) modified several provisions of the California Revised Uniform Limited Liability Company Act, including clarifying that actions against, and obligations of, the LLC are not abated after the filing a certificate of cancelation.

PRIOR VOTES:

Assembly Floor (Ayes 71, Noes 0)

Assembly Banking and Finance Committee (Ayes 10, Noes 0)
