

LIMITED LIABILITY COMPANIES

Formation, Operation, and Conversion

Second Edition

2001 Supplement

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Editor



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CHAPTER 1

LIMITED LIABILITY COMPANIES: AN INTRODUCTION

§ 1.10 SELF-EMPLOYMENT TAX ISSUES

Page 14, add at the bottom of the page immediately preceding the heading “[D] Cautions and Conclusions”:

There have been various legislative proposals to attempt to address the self-employment tax problem. The most basic proposal, supported by the American Bar Association Section of Taxation, would be to amend the Code to provide that income of owners of an entity taxable as a partnership (this would include a partnership or an LLC) which is attributable to capital is no longer subject to self-employment tax. Specifically, the proposal was to amend Code Section 1402(a)(13) to provide that income attributable to capital is excluded from the definition of “net earnings from self-employment,” regardless of whether the taxpayer is a general partner, a limited partner, a member of an LLC, or a member of any other entity that is taxed as a partnership for federal income tax purposes.

In addition to the American Bar Association Section of Taxation, the American Institute of Certified Public Accountants (AICPA) Tax Division has made its own recommendations. These are consistent with the above noted items. For discussion of this issue, *see* “ABA Tax Section Suggests Legislative Fix for LLC Self-Employment Tax,” *Tax Notes* (July 19, 1999), p. 469. *See also* “ABA/AICPA Have Legislative Fix for LLC Self-Employment Tax Problem,” *Tax Notes* (July 19, 1999), p. 351.

Against this background, and the discussion of the case law included here, some have said that taxpayers should take (and apparently many are taking) very aggressive positions. There are practitioners who would apply Code Section 1402(a)(13) only to actual limited partners and actual limited partnerships. Thus, they would attempt to minimize self-employment tax to the maximum extent possible. What clearly seems necessary

is the statutory change (whether the one recommended by the ABA and AICPA, or some other). For a good discussion of the current quandary of practitioners, *see* “RABI and RABI, Partners, LLC Members, and SE Tax,” *Tax Notes* (May 1, 2000), p. 665.

CHAPTER 2

LEGAL LIABILITY CONSIDERATION IN CHOOSING A FORM OF A BUSINESS

§ 2.05 TYPES OF LIABILITY

Page 23, add immediately preceding the heading “[B] Tort Liability”:

One fundamental point which deserves re-emphasis is that even an LLC will not free the owners of the LLC from liability if the third party insists on individual contractual liability. The classic example would be a contract or lease entered into by the LLC, but as to which a personal guaranty of the LLC’s owner is required. Here, the LLC would have primary liability, but the individual guarantor would have secondary liability. This does not mean that the liability limitation feature of an LLC is without value. It is only the amount of the guaranty (and the guaranteed obligations) that would give rise to individual liability.

§ 2.10 LIABILITY OF LIMITED LIABILITY COMPANIES

Page 31, add at the bottom of the page immediately preceding the heading at the top of page 32 “[B] Piercing the Corporate Veil”:

Planning Tip. It bears repeating that guarantees, or any contract in which individual members of an LLC enter into a direct payment obligation, should be carefully thought out. Although a third party (such as a lender or lessor) may absolutely require individual guarantees, one big question will be whether such a guarantee is *pro rata* according to the membership interests in the LLC, or is joint and several.

For example, does it make any sense for a 10 percent member of an LLC to be guaranteeing 100 percent of a lease obligation? The answer is surely no, yet occasionally one sees this kind of document. A landlord may want to be able to pursue any and all members of the LLC for an obligation (such as rent) and therefore may insist on joint and several lia-

bility. However, particularly in larger LLCs with multiple members, this kind of position should be avoided by the individual LLC members whenever possible.

Page 34, add immediately preceding the heading “Section 2.11 Limited Liability Partnerships”:

Although a body of case law will presumably start to develop, most practitioners are well aware that it may be many years before there is a large body of authority in any state concerning the piercing of the LLC’s veil of liability limitation. At the same time, now that LLCs have been in existence for some years, many practitioners are becoming more used to advising their clients about the traditional factors that spelled trouble under the old piercing-the-corporate-veil doctrine.

Such matters as corporate formalities (or here, LLC organizational and maintenance formalities), the holding out of the LLC as doing business (and individual members of the LLC not holding themselves out as doing business), etc., should all be relevant. As there is no requirement in most jurisdictions that LLC members hold regular meetings and prepare minutes (as is the case with corporations), if anything, the “piercing the veil” concerns should be much less with an LLC. At the same time, prudence suggests that some of these formalities be followed merely as a means of bolstering the liability limitation of the LLC.

CHAPTER 3

COMPARING LLCs TO S CORPORATIONS AND PARTNERSHIPS

§ 3.02 LLC OPERATIONS

Page 57, add at the bottom of the page immediately preceding the “Background” heading at the top of page 58:

Note: In reading the check-the-box regulations which follow, it should be born in mind that the IRS has, since these regulations were released, announced a follow-up program. The question concerns the authority of representatives (rather than the taxpayers themselves) to check the box and otherwise resolve tax processing issues without first executing a power of attorney. This initiative would expand the check-the-box authority to family members and friends and to business returns. The IRS has not given a target date for these expansions, but has indicated that it intends to implement these procedures in the future. For details, see Hamilton, “IRS Unveils Follow-Up to ‘Checkbox Initiative,’” *Tax Notes* (June 26, 2000), p. 1697. The IRS is seeking ways to alleviate the problem of not always being able to find, on a timely basis, someone with authority to check the box and mail in the form.

CHAPTER 5

TAX CLASSIFICATION OF THE LIMITED LIABILITY COMPANY

§ 5.02 CHECK-THE-BOX REGULATIONS

Page 167, add immediately preceding the heading “Section 5.03 One-Member LLCs”:

EXPANSION OF AUTHORITY

Note: In reading the check-the-box regulations which follow, it should be born in mind that the IRS has, since these regulations were released, announced a follow-up program. The question concerns the authority of representatives (rather than the taxpayers themselves) to check the box and otherwise resolve tax processing issues without first executing a power of attorney. This initiative would expand the check-the-box authority to family members and friends and to business returns. The IRS has not given a target date for these expansions, but has indicated that it intends to implement these procedures in the future. For details, *see* Hamilton, “IRS Unveils Follow-Up to ‘Checkbox Initiative,’” *Tax Notes* (June 26, 2000), p. 1697. The IRS is seeking ways to alleviate the problem of not always being able to find, on a timely basis, someone with authority to check the box and mail in the form.

§ 5.03 ONE-MEMBER LLCs

Page 168, add immediately preceding the heading “[A] Advantages of One Number LLCs”:

There have been a variety of good discussions of single member LLCs, so-called “tax nothings.” For example, a thorough review appears in Miller, “The Strange Materialization of the Tax Nothing,” *Tax Notes* (May 1, 2000), p. 685.

Page 176, add immediately preceding the heading “[4] Associations Electing to Be Partnerships”:

There have been a variety of good discussions of single member LLCs, so-called “tax nothings.” For example, a thorough review appears in Miller, “The Strange Materialization of the Tax Nothing,” *Tax Notes* (May 1, 2000), p. 685.

CHAPTER 6

TREATMENT OF SINGLE-MEMBER LLCs

§ 6.01 INTRODUCTION

Page 200, add immediately preceding the heading “Section 6.02 Single-Member LLCs in Various Jurisdictions”:

For an excellent discussion of the emergence of the single-member LLC and various planning techniques, *see* Miller, “The Strange Materialization of the Tax Nothing,” *Tax Notes* (May 1, 2000), p. 685.

§ 6.09 MORE THOUGHTS ABOUT TAX NOTHINGS

Page 211, add at the very end of the page:

For an excellent discussion of single-member LLCs, so-called “tax nothing,” *see* Miller, “The Strange Materialization of the Tax Nothing,” *Tax Notes* (May 1, 2000), p. 685.

CHAPTER 10

ESTATE PLANNING AND LIMITED LIABILITY COMPANIES

§ 10.03 PLANNING POINTERS IN USING LLCs IN ESTATE PLANNING

Page 383, add immediately preceding the heading “[I] The Trust Alternative”:

Family LLCs or family partnerships can be effectively used for estate planning concerns. The IRS has long attacked such transactions, particularly where very aggressive valuation discounts are used. The IRS has not fared too well in much of the case law. However, for a recent report concerning one IRS victory, *see* Kisner, “IRS Finally Wins One in Family Partnership Battle,” *Tax Notes* (June 26, 2000), p. 1767.

APPENDIX H

FORM 3: OPERATING AGREEMENT FOR SINGLE CLASS, LLC, A CALIFORNIA LIMITED LIABILITY COMPANY

[Editor's Note: A simple form of single class operating agreement for an LLC. Includes typical provisions for management control, tax issues, allocation and distribution of profits and losses, transfer restrictions, dissolution and indemnity. Provided by Edward R. Sarti of Robert W. Wood Professional Corporation.]

OPERATING AGREEMENT FOR SINGLE CLASS, LLC, A CALIFORNIA LIMITED LIABILITY COMPANY

This Operating Agreement (this "Agreement") is effective as of September 16, 2001 ("Effective Date"), by and between John Member ("Member" or "Managing Member") and such other persons who are accepted as Members and execute this Agreement (all such persons are collectively referred to as the "Members" or individually as a "Member"), with reference to the following facts:

A. The Member has filed Articles of Organization (the "Articles") for Single Class, LLC (the "Company"), a limited liability company under the laws of the State of California, with the California Secretary of State.

B. The Member desires to adopt and approve an operating agreement for the Company under the Beverly-Killea Limited Liability Company Act (the "Act").

NOW, THEREFORE, the Member by this Agreement sets forth the operating agreement for the Company upon the terms and subject to the conditions of this Agreement.

ARTICLE I
ORGANIZATIONAL MATTERS

1.1. NAME. The name of the Company shall be “Single Class, LLC.” The Company may conduct business under that name or any other name approved by the Managing Member.

1.2. TERM. The term of the Company commenced as of the date of the filing of the Articles and shall continue until dissolved and liquidated pursuant to the provisions of Article IX.

1.3. OFFICE AND AGENT. The Company shall continuously maintain an office and registered agent in the State of California as required by the Act. The principal office of the Company shall be as stated in the Articles, or such other location as the Managing Member may determine. The registered agent shall be as stated in the Articles or as otherwise determined by the Managing Member.

1.4. BUSINESS OF THE COMPANY. Notwithstanding the purpose of the Company which is described in the Articles, the Company shall not engage in any business other than the following without the consent of the Managing Member:

(a) the business of managing and operating _____;

(b) such other activities directly related to the foregoing business as may be necessary or advisable in the reasonable opinion of the Managing Member to further such business and which is not prohibited by the Act or other applicable law; and

(c) any other lawful business as determined by the Managing Member.

1.5. LIMITED LIABILITY. Except as otherwise provided expressly in this Agreement or required by law, no Member shall be personally liable for any debt, obligation, or liability of the Company, whether that debt, obligation, or liability arises in contract, tort, or otherwise.

1.6. TAX CLASSIFICATION. During such time as there is only one Member, the Member intends the Company not to be classified as a separate entity for federal and, to the maximum extent possible, state income

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taxes. Nevertheless, the Member acknowledges the Company's status as a limited liability company formed under the Act and no Member shall take any action inconsistent with the express intent of this Agreement. If additional Members are admitted hereto, the Managing Member shall determine if the Company shall constitute a partnership for federal or state income tax purposes.

ARTICLE II CAPITAL CONTRIBUTIONS

2.1. CAPITAL CONTRIBUTIONS. Each Member shall make a capital contribution to the Company in the amount shown opposite the Member's name in Exhibit A attached hereto. No Member shall be required to make any additional contributions to the capital of the Company. Additional contributions to the capital of the Company shall be made only with the consent of the Managing Member. Each Member shall receive a credit to that Member's Capital Account in the amount of any additional capital which that Member contributes to the Company. Immediately following such capital contributions ("Capital Contributions"), the percentage interests shall be adjusted, and Exhibit A shall be revised, to reflect the new relative proportions of the Members' Capital Accounts.

2.2. CAPITAL ACCOUNTS. The Company shall establish an individual capital account ("Capital Account") for each Member. The Company shall determine and maintain each Capital Account in accordance with Treasury Regulations Section 1.704-1(b)(2)(iv). Upon a valid transfer of a Member's interest in the Company ("Membership Interest") in accordance with Article VI, such Member's Capital Account shall carry over to the new owner.

2.3. NO INTEREST. The Company shall not pay any interest on Capital Contributions or Capital Account balances.

2.4. RETURN OF CAPITAL. Except as provided in this Agreement, no Member may withdraw his or her Capital Contribution. No Member guarantees the return of another Member's Capital Contribution. No Member is required to contribute or to lend any cash or property to the Company to enable the Company to return any Member's Capital Contributions.

LIMITED LIABILITY COMPANIES

2.5. MEMBER LOANS. No Member shall lend or advance money to or for the Company's benefit without the Managing Member's prior written consent. A loan by any Member shall not be treated as a Capital Contribution by that Member or entitle that Member to an increase in that Member's percentage interest. The loan amount shall be a debt due from the Company, repayable out of the Company's cash, and shall be on such terms as the Company and that Member shall agree. Notwithstanding the foregoing, no Member shall be required to make any loans to the Company or guarantee the payment or performance of any Company obligation.

ARTICLE III MEMBERS

3.1. MEMBERS. The name, mailing address, taxpayer identification number, and percentage interest of each Member are specified in Exhibit A to this Agreement.

3.2. ADMISSION OF ADDITIONAL MEMBERS. Additional Members may be admitted with the approval of the Managing Member. Additional Members will participate in the "Net Profits," "Net Losses" (as such terms are defined in Section 5.1), and distributions of the Company on such terms as are determined by the Members. This Agreement, including Exhibit A, shall be amended upon the admission of an additional Member to set forth such Member's name, mailing address, taxpayer identification number and capital contribution, and to evidence the additional Member's consent to be bound by the provisions of this Agreement.

3.3. WITHDRAWALS OR RESIGNATIONS. No Member may withdraw, retire, or resign from the Company, unless written unanimous consent is obtained from the Members.

ARTICLE IV MANAGEMENT AND CONTROL OF THE COMPANY

4.1. MANAGEMENT AND POWERS. The Company's business, assets and affairs shall be managed exclusively by John Member ("Managing Member"). The Managing Member, except as otherwise provided in this Agreement, shall have full, complete and exclusive authority, discretion and power to supervise, direct and control the Company's

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business and affairs, including, without limitation, the power to exercise on behalf and in the name of the Company all of the powers described in Section 17003 of the Act. The Managing Member may be removed only by an affirmative vote of the Members holding a majority of the Membership Interests.

4.2. LIMITATIONS ON POWER OF THE MANAGING MEMBER.

The Managing Member, or if there is then more than one Member, a majority of the Membership Interests shall have the authority to engage in the following transactions:

- (i) The sale, exchange or other disposition of all, or substantially all, of the Company's assets occurring as part of a single transaction or plan, or in multiple transactions over a twelve-month period, except in the orderly liquidation and winding up of the business of the Company upon its duly authorized dissolution.
- (ii) The merger of the Company with another limited liability company or corporation, general partnership, limited partnership, or other entity (except that any act which would cause a Member to incur personal liability for the obligations of the Company or its successor shall also require the consent of such Member).
- (iii) Any act which would make it impossible to carry on the ordinary business of the Company.
- (iv) The confession of a judgment against the Company.
- (v) Any other transaction described in this Agreement as requiring the approval, consent, or vote of the Members holding a majority of the Membership Interests.
- (vi) Making an assignment for the benefit of creditors, or taking or suffering any action under any insolvency or bankruptcy act, or admitting in writing an act of insolvency.
- (vii) Transferring, hypothecating, compromising, or releasing any Company claim except on payment in full.
- (viii) Knowingly suffering or causing anything to be done whereby any Company property may be seized or attached or

taken in execution, or its ownership or possession otherwise endangered.

4.3. **MEMBER MEETINGS AND APPROVAL.** No annual or regular meetings of the Members are required to be held. However, if such meetings are held, such meetings shall be noticed, held and conducted pursuant to the Act. In any instance in which the approval of the Members is required under this Agreement, such approval may be obtained in any manner permitted by the Act. Unless otherwise provided in this Agreement, approval of the Members shall mean the approval by Members holding a majority of the Membership Interests.

4.4. **DEVOTION OF TIME.** The Managing Member shall devote whatever time or effort as he or she deems appropriate for the furtherance of the Company's business.

4.5. **COMPETING ACTIVITIES.** The Members, including the Managing Member, and their affiliates may engage or invest in any activity, including without limitation those that might be in direct or indirect competition with the Company. Neither the Company nor any Member shall have any right in or to such other activities or to the income or proceeds derived therefrom. No Member shall be obligated to present any investment opportunity to the Company, even if the opportunity is of the character that, if presented to the Company, could be taken by the Company. Each Member shall have the right to hold any investment opportunity for his or her own account or to recommend such opportunity to persons other than the Company. The Members acknowledge that certain Members and their Affiliates own and/or manage other businesses, including businesses that may compete with the Company and for the Members' time. Each Member hereby waives any and all rights and claims which he or she may otherwise have against the other Members and their affiliates as a result of any of such activities.

4.6. **TRANSACTIONS BETWEEN THE COMPANY AND THE MEMBERS.** Notwithstanding that it may constitute a conflict of interest, the Members and their affiliates may engage in any transaction with the Company so long as such transaction is not expressly prohibited by this Agreement and so long as the terms and conditions of such transaction, on an overall basis, are fair and reasonable to the Company and are at least as favorable to the Company as those that are generally available

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from persons capable of similarly performing them or if Members holding a majority of the Membership Interests approve the transaction in writing.

4.7. INDEMNIFICATION. The Company shall indemnify, defend, and hold harmless each Member from and against any and all liabilities of every kind, arising from or relating to the Company's business, except as to those matters arising from such Members' fraud, gross negligence, willful misconduct, or breach of fiduciary duty.

4.8. REMUNERATION TO MEMBERS.

(a) Unless approved by the Members, no Member or an affiliate of a Member shall be entitled to remuneration for services rendered or goods provided to, or on behalf of, the Company. Any compensation paid by the Company to a Member or an affiliate of a Member pursuant to this Section 4.8 shall be treated as a payment to a person who is not a Member under Code Section 707(a) or 707(c).

(b) Notwithstanding Section 4.8(a) above, the Company shall reimburse the Member for all reasonable out-of-pocket expenses incurred by the Member in the proper conduct of the Company's business. The Member requesting such reimbursement must first present to the Company expense statements, vouchers and such other supporting information that complies with the requirements of Code Section 274.

ARTICLE V ALLOCATIONS OF NET PROFITS AND NET LOSSES AND DISTRIBUTIONS

5.1. DEFINITIONS. When used in this Agreement, the following terms shall have the meanings set forth below:

"Code" shall mean the Internal Revenue Code of 1986, as amended from time to time, the provisions of succeeding law, and to the extent applicable, the Treasury Regulations.

"Company Minimum Gain" shall have the meaning ascribed to the term "Partnership Minimum Gain" in the Treasury Regulations Section 1.704-2(d).

“Member Nonrecourse Debt” shall have the meaning ascribed to the term “Partner Nonrecourse Debt” in Treasury Regulations Section 1.704-2(b)(4).

“Member Nonrecourse Deductions” shall mean items of Company loss, deduction, or Code Section 705(a)(2)(B) expenditures which are attributable to Member Nonrecourse Debt.

“Net Profits” and “Net Losses” shall mean the income, gain, loss, deductions, and credits of the Company in the aggregate or separately stated, as appropriate, determined in accordance with the method of accounting at the close of each fiscal year employed on the Company’s information tax return filed for federal income tax purposes.

“Nonrecourse Liability” shall have the meaning set forth in Treasury Regulations Section 1.752-1(a)(2).

“Treasury Regulations” shall mean the final or temporary regulations that have been issued by the U.S. Department of Treasury pursuant to its authority under the Code, and any successor regulations.

5.2. ALLOCATIONS OF NET PROFIT AND NET LOSS.

(a) Net Loss. Net Loss shall be allocated to the Members in proportion to their Membership Interests. Notwithstanding the previous sentence, loss allocations to a Member shall be made only to the extent that such loss allocations will not create a deficit Capital Account balance for that Member in excess of an amount, if any, equal to such Member’s share of Company Minimum Gain that would be realized on a foreclosure of the Company’s property. Any loss not allocated to a Member because of the foregoing provision shall be allocated to the other Members (to the extent the other Members are not limited in respect of the allocation of losses under this Section 5.2(a)). Any loss reallocated under this Section 5.2(a) shall be taken into account in computing subsequent allocations of income and losses pursuant to this Article V, so that the net amount of any item so allocated and the income and losses allocated to each Member pursuant to this Article V, to the extent possible, shall be equal to the net amount that would have been allocated to each such Member pursuant to

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this Article V if no reallocation of losses had occurred under this Section 5.2(a).

(b) Net Profit. Net Profit shall be allocated equally among the Members in proportion to their Membership Interests.

5.3. SPECIAL ALLOCATIONS. Notwithstanding Section 5.2:

(a) Minimum Gain Chargeback. If there is a net decrease in Company Minimum Gain during any fiscal year, each Member shall be specially allocated items of Company income and gain for such fiscal year (and, if necessary, in subsequent fiscal years) in an amount equal to the portion of such Member's share of the net decrease in Company Minimum Gain that is allocable to the disposition of Company property subject to a Nonrecourse Liability, which share of such net decrease shall be determined in accordance with Treasury Regulations Section 1.704-2(g)(2). Allocations pursuant to this Section 5.3(a) shall be made in proportion to the amounts required to be allocated to each Member under this Section 5.3(a). The items to be so allocated shall be determined in accordance with Treasury Regulations Section 1.704-2(f). This Section 5.3(a) is intended to comply with the minimum gain chargeback requirement contained in Treasury Regulations Section 1.704-2(f) and shall be interpreted consistently therewith.

(b) Chargeback of Minimum Gain Attributable to Member Nonrecourse Debt. If there is a net decrease in Company Minimum Gain attributable to a Member Nonrecourse Debt, during any fiscal year, each Member who has a share of the Company Minimum Gain attributable to such Member Nonrecourse Debt (which share shall be determined in accordance with Treasury Regulations Section 1.704-2(i)(5)) shall be specially allocated items of Company income and gain for such fiscal year (and, if necessary, in subsequent fiscal years) in an amount equal to that portion of such Member's share of the net decrease in Company Minimum Gain attributable to such Member Nonrecourse Debt that is allocable to the disposition of Company property subject to such Member Nonrecourse Debt (which share of such net decrease shall be determined in accordance with Treasury Regulations Section 1.704-2(i)(5)). Allocations pursuant to this Section 5.3(b) shall be made in proportion to the amounts required to be allocated to each Member under this Section 5.3(b). The items to be so allocated shall be determined in accordance

with Treasury Regulations Section 1.704-2(i)(4). This Section 5.3(b) is intended to comply with the minimum gain chargeback requirement contained in Treasury Regulations Section 1.704-2(i)(4) and shall be interpreted consistently therewith.

(c) **Nonrecourse Deductions.** Any nonrecourse deductions (as defined in Treasury Regulations Section 1.704-2(b)(1)) for any fiscal year or other period shall be specially allocated to the Members in proportion to their Membership Interests.

(d) **Member Nonrecourse Deductions.** Those items of Company loss, deduction, or Code Section 705(a)(2)(B) expenditures which are attributable to Member Nonrecourse Debt for any fiscal year or other period shall be specially allocated to the Member who bears the economic risk of loss with respect to the Member Nonrecourse Debt to which such items are attributable in accordance with Treasury Regulations Section 1.704-2(i).

(e) **Qualified Income Offset.** If a Member unexpectedly receives any adjustments, allocations, or distributions described in Treasury Regulations Section 1.704-1(b)(2)(ii)(d)(4), (5) or (6), or any other event creates a deficit balance in such Member's Capital Account in excess of such Member's share of Company Minimum Gain, items of Company income and gain shall be specially allocated to such Member in an amount and manner sufficient to eliminate such excess deficit balance as quickly as possible. Any special allocations of items of income and gain pursuant to this Section 5.3(e) shall be taken into account in computing subsequent allocations of income and gain pursuant to this Article V so that the net amount of any item so allocated and the income, gain, and losses allocated to each Member pursuant to this Section 5.3(e) to the extent possible, shall be equal to the net amount that would have been allocated to each such Member pursuant to the provisions of this Article V if such unexpected adjustments, allocations, or distributions had not occurred.

5.4. CODE SECTION 704(c) ALLOCATIONS. Notwithstanding any other provision in this Article V, in accordance with Code Section 704(c) and the Treasury Regulations promulgated thereunder, income, gain, loss, and deduction with respect to any property contributed to the capital of the Company shall, solely for tax purposes, be allocated among

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the Members so as to take account of any variation between the adjusted basis of such property to the Company for federal income tax purposes and its fair market value on the date of contribution. Allocations pursuant to this Section 5.4 are solely for purposes of federal, state, and local taxes. As such, they shall not affect or in any way be taken into account in computing a Member's Capital Account or share of profits, losses, or other items of distributions pursuant to any provision of this Agreement.

5.5. DISTRIBUTION OF NET INCOME BY THE COMPANY. Subject to applicable law and any limitations contained elsewhere in this Agreement, Members may from time to time approve distributions of net income from the Company. Distributions of net income shall be first to the Members in proportion to their unreturned Capital Contributions until each Member has recovered his or her Capital Contributions, and then to the Members in proportion to their Membership Interests.

ARTICLE VI TRANSFER AND ASSIGNMENT OF INTERESTS

6.1. TRANSFER AND ASSIGNMENT OF INTERESTS. No Member shall be entitled to transfer, assign, convey, sell, encumber, or in any way alienate all or any part of his or her Membership Interest (collectively, "transfer") except with the prior approval of the Members holding a majority of the Membership Interests, which approval may be given or withheld in the sole discretion of the Members.

6.2. SUBSTITUTION OF MEMBERS. A transferee of a Membership Interest shall have the right to become a substitute Member only if consent of the Members is given in accordance with Section 6.1, such person executes an instrument satisfactory to the Members accepting and adopting the terms and provisions of this Agreement, and such person pays any reasonable expenses in connection with his or her admission as a new Member. The admission of a substitute Member shall not release the Member who assigned the Membership Interest from any liability that such Member may have to the Company.

6.3. TRANSFERS IN VIOLATION OF THIS AGREEMENT AND TRANSFERS OF PARTIAL MEMBERSHIP INTERESTS. Upon a transfer in violation of this Article VI, the transferee shall have no right to vote or participate in the management of the Company or to exercise any

rights as a Member. Such transferee shall be entitled to receive only the share of the Company's Net Profits, Net Losses, and distributions of the Company's assets to which the transferor would otherwise have been entitled. Notwithstanding the immediately preceding sentences, if, in the determination of the remaining Members, a transfer in violation of this Article VI would cause the termination of the Company under the Code, in the sole discretion of the remaining Members, the purported transfer shall be null and void.

6.4. PERMITTED TRANSFERS. A Member may transfer all or any part of that Member's Membership Interest in trust for the benefit of that Member, or that Member's spouse, children, grandchildren, siblings or in-laws, or any combination thereof, provided (a) the Member is a trustee or co-trustee of the trust, and (b) such Member, as trustee or co-trustee, agrees in writing to be bound by the provisions of this Agreement ("Permitted Transfer").

6.5. TRANSFEREE AS A MEMBER. An assignee of a Membership Interest shall have the right to become a substitute Member only if (a) the Members consent to the assignee's admission to the Company as a Member, (b) the assignee executes an instrument satisfactory to the Members accepting and adopting the provisions of this Agreement, and (c) the assignee pays any reasonable expenses in connection with his admission as a new Member.

ARTICLE VII
CONSEQUENCES OF DISSOLUTION EVENTS
AND TERMINATION OF MEMBERSHIP INTEREST

7.1. DISSOLUTION EVENT. Upon the occurrence of the death, withdrawal, resignation, retirement, insanity, or bankruptcy of any Member ("Dissolution Event"), the Company shall dissolve unless the Members consent within ninety (90) days of the Dissolution Event to the continuation of the business of the Company. If the Members so consent, the Company or the remaining Members shall have the right to purchase, and if such right is exercised, the Member (or his or her legal representative) whose actions or conduct resulted in the Dissolution Event ("Former Member") shall sell, the Former Member's Membership Interest ("Former Member's Interest") as provided in this Article VII.

APPENDIX H

7.2. WITHDRAWAL. Notwithstanding Section 7.1, upon the withdrawal by a Member in accordance with Section 3.3 such Member shall be treated as a Former Member, and, unless the Company dissolves as a result of such withdrawal, the Company or the remaining Members shall have the right to purchase, and if such right is exercised, the Former Member shall sell, the Former Member's Interest as provided in this Article VII.

7.3. PURCHASE PRICE. The purchase price for the Former Member's Interest shall be the fair market value of the Former Member's Interest as determined by an independent appraiser jointly selected by the Former Member and by remaining Members holding a majority of the remaining Membership Interests. The Company and the Former Member shall each pay one-half of the cost of the appraisal. Notwithstanding the foregoing, if the Dissolution Event results from a breach of this Agreement by the Former Member, the purchase price shall be reduced by an amount equal to the damages suffered by the Company or the remaining Members as a result of such breach.

7.4. NOTICE OF INTENT TO PURCHASE. Within thirty (30) days after the fair market value of the Former Member's Interest has been determined in accordance with Section 7.3, each remaining Member shall notify the Managing Member in writing of his or her desire to purchase a portion of the Former Member's Interest. The failure of any remaining Member to submit a notice within the applicable period shall constitute an election on the part of the Member not to purchase any of the Former Member's Interest. Each remaining Member so electing to purchase shall be entitled to purchase a portion of the Former Member's Interest in the same proportion that the Membership Interest of the remaining Member bears to the aggregate of the Membership Interests of all of the remaining Members electing to purchase the Former Member's Interest.

7.5. ELECTION TO PURCHASE LESS THAN ALL OF THE FORMER MEMBER'S INTEREST. If any remaining Member elects to purchase none or less than all of his or her pro rata share of the Former Member's Interest, then the remaining Members can elect to purchase more than their pro rata share. If the remaining Members fail to purchase the entire interest of the Former Member, the Company shall purchase any remaining share of the Former Member's Interest. Any purchase of a Former Member's Interest must be the entire interest.

**ARTICLE VIII
ACCOUNTING, RECORDS, REPORTING BY MEMBERS**

8.1. **BOOKS AND RECORDS.** The books and records of the Company shall be kept by the Managing Member in accordance with the accounting methods followed for federal income tax purposes. The Company shall maintain at its principal office in California all of the following:

(a) A current list of the full name and last known business or residence address of each Member set forth in alphabetical order, together with the Capital Contributions, Capital Account, and Membership Interest of each Member;

(b) A copy of the Articles and any and all amendments thereto together with executed copies of any powers of attorney pursuant to which the Articles or any amendments thereto have been executed;

(c) Copies of the Company's federal, state, and local income tax or information returns and reports, if any, for the six (6) most recent taxable years;

(d) A copy of this Agreement and any and all amendments thereto together with executed copies of any powers of attorney pursuant to which this Agreement or any amendments thereto have been executed;

(e) Copies of the financial statements of the Company, if any, for the six (6) most recent fiscal years; and

(f) The Company's books and records as they relate to the internal affairs of the Company for at least the current and past four (4) fiscal years.

8.2. **REPORTS.** The Company shall cause to be filed, in accordance with the Act, all reports and documents required to be filed with any governmental agency. The Company shall cause to be prepared at least annually information concerning the Company's operations necessary for the completion of the Members' federal and state income tax returns. The Company shall send or cause to be sent to each Member within ninety (90) days after the end of each taxable year (i) such information as is necessary to complete the Members' federal and state income tax or information returns, and (ii) a copy of the Company's federal, state, and local income tax or information returns for the year.

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8.3. BANK ACCOUNTS. The Managing Member shall maintain the funds of the Company in one or more separate bank accounts in the name of the Company, and shall not permit the funds of the Company to be commingled in any fashion with the funds of any other person or entity. Only the Managing Member is authorized to endorse checks, drafts, and other evidences of indebtedness made payable to the order of the Company, but only for the purpose of deposit into the Company's accounts. Checks, drafts, and other instruments obligating the Company to pay money in any amount may be signed only by the Managing Member.

8.4. TAX MATTERS FOR THE COMPANY. John Member is designated as "Tax Matters Partner" (as defined in Code Section 6231), to represent the Company (at the Company's expense) in connection with all examination of the Company's affairs by tax authorities and to expend Company funds for professional services and costs associated therewith.

ARTICLE IX DISSOLUTION AND WINDING UP

9.1. CONDITIONS OF DISSOLUTION. The Company shall dissolve upon the occurrence of any of the following events:

(a) Upon the happening of any event of dissolution specified in the Articles;

(b) Upon the entry of a decree of judicial dissolution pursuant to Section 17351 of the Corporations Code;

(c) Upon an affirmative vote of Members holding a majority of the Membership Interests;

(d) The occurrence of a Dissolution Event and the failure of the Members to consent in accordance with Section 7.1 to continue the business of the Company within ninety (90) days after the occurrence of such event; or

(e) The sale of all or substantially all of the assets of Company.

9.2. WINDING UP. Upon the dissolution of the Company, the Company's assets shall be disposed of and its affairs wound up. The Company shall give written notice of the commencement of the dissolution to all of its known creditors.

LIMITED LIABILITY COMPANIES

9.3. LIMITATIONS ON PAYMENTS MADE IN DISSOLUTION. Except as otherwise specifically provided in this Agreement, each Member shall be entitled to look only to the assets of the Company for the return of his or her positive Capital Account balance and shall have no recourse for his or her Capital Contribution and/or share of Net Profits against any other Member.

9.4. CERTIFICATES. The Company shall file with the California Secretary of State a Certificate of Dissolution upon the dissolution of the Company and a Certificate of Cancellation upon the completion of the winding up of the Company's affairs.

ARTICLE X INDEMNIFICATION

10.1. INDEMNIFICATION OF AGENTS. The Company shall indemnify any Member and may indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action, suit or proceeding by reason of the fact that he or she is or was a Member, officer, employee, or other agent of the Company or that, being or having been such a Member, officer, employee, or agent, he or she is or was serving at the request of the Company as a manager, director, officer, employee, or other agent of another limited liability company, corporation, partnership, joint venture, trust, or other enterprise (all such persons being referred to hereinafter as an "agent"), to the fullest extent permitted by applicable law in effect on the date hereof and to such greater extent as applicable law may hereafter from time to time permit.

ARTICLE XI MISCELLANEOUS

11.1. COMPLETE AGREEMENT. This Agreement and the Articles constitute the complete and exclusive statement of agreement among the Members with respect to the subject matter herein and replace and supersede all prior written and oral agreements among the Members. To the extent that any provision of the Articles conflict with any provision of this Agreement, the Articles shall control.

11.2. BINDING EFFECT. Subject to the provisions of this Agreement relating to transferability, this Agreement will be binding upon and inure to the benefit of the Members and their respective successors and assigns.

APPENDIX H

11.3. INTERPRETATION. All pronouns shall be deemed to refer to the masculine, feminine, or neuter, singular or plural, as the context in which they are used may require. All headings herein are inserted only for convenience and ease of reference and are not to be considered in the interpretation of any provision of this Agreement. Numbered or lettered articles, sections, and subsections herein contained refer to articles, sections, and subsections of this Agreement unless otherwise expressly stated. In the event any claim is made by any Member relating to any conflict, omission, or ambiguity in this Agreement, no presumption or burden of proof or persuasion shall be implied by virtue of the fact that this Agreement was prepared by or at the request of a particular Member or his or her counsel.

11.4. JURISDICTION. Each Member hereby consents to the exclusive jurisdiction of the state and federal courts sitting in California in any action on a claim arising out of, under, or in connection with this Agreement or the transactions contemplated by this Agreement. Each Member further agrees that personal jurisdiction over him or her may be effected by service of process by registered or certified mail addressed as provided in Section 11.7 of this Agreement, and that when so made shall be as if served upon him or her personally within the State of California.

11.5. ARBITRATION. Except as otherwise provided in this Agreement, any controversy between the parties arising out of this Agreement shall be submitted to the American Arbitration Association for arbitration in San Francisco, California. The costs of the arbitration, including any American Arbitration Association administration fee, the arbitrator's fee, and costs for the use of facilities during the hearings, shall be borne equally by the parties to the arbitration. Attorneys' fees may be awarded to the prevailing or most prevailing party at the discretion of the arbitrator. The provisions of Sections 1282.6, 1283, and 1283.05 of the California Code of Civil Procedure shall apply to the arbitration. The arbitrator shall not have any power to alter, amend, modify, or change any of the terms of this Agreement nor to grant any remedy which is either prohibited by the terms of this Agreement, or not available in a court of law.

11.6. SEVERABILITY. If any provision of this Agreement or the application of such provision to any person or circumstance shall be held invalid, the remainder of this Agreement or the application of such provision to persons or circumstances other than those to which it is held invalid shall not be affected thereby.

LIMITED LIABILITY COMPANIES

11.7. NOTICES. Any notice to be given or to be served upon the Company or any party hereto in connection with this Agreement must be in writing (which may include facsimile) and will be deemed to have been given and received when delivered to the address specified by the party to receive the notice. Such notices will be given to a Member at the address specified in Exhibit A hereto. Any party may, at any time by giving five (5) days' prior written notice to the other Members, designate any other address in substitution of the foregoing address to which such notice will be given. The Company's address shall be the same as it appears in the Articles.

11.8. AMENDMENTS. All amendments to this Agreement will be in writing and approved and signed by Members holding a majority of the Membership Interests.

11.9. MULTIPLE COUNTERPARTS. This Agreement may be executed in two or more counter parts, each of which shall be deemed an original, but all of which shall constitute one and the same instrument.

11.10. ATTORNEY FEES. In the event that any dispute between the Company and the Members or among the Members should result in litigation or arbitration, the prevailing party in such dispute shall be entitled to recover from the other party all reasonable fees, costs, and expenses of enforcing any right of the prevailing party, including without limitation, reasonable attorneys' fees and expenses, all of which shall be deemed to have accrued upon the commencement of such action and shall be paid whether or not such action is prosecuted to judgment.

IN WITNESS WHEREOF, the sole Member of Single Class, LLC, a California Limited Liability Company, has executed this Agreement, effective as of the date written above.

JOHN MEMBER, MEMBER

APPENDIX H

EXHIBIT A

Capital Contribution and Addresses of Members as of _____, 2001

Member's Name	John Member
Member's Address	_____ _____ _____
Member's Tax Identification Number	_____
Fair Market Value of Member's Capital Contribution	\$ _____
Member's Membership Interest	100%

