

Legal Risk Management Tip
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CALIFORNIA 2015 OUTLOOK: NEW LAWS THAT MAY AFFECT YOUR BUSINESS

With the new-year comes new-rules. Literally hundreds¹ of new laws will go into effect in the state of California during the month of January, with even more becoming effective later in 2015. This article provides an overview of some of the new corporate laws affecting businesses. While this article is geared towards California businesses, several other states have substantially similar laws in place, or are in the process of enacting such laws. Further, out-of-state companies that operate in California are often subject to the rules of the state, so it is important to be aware of how such rules may impact your business.

1. Limits on the Use of Mandatory Arbitration Agreements – AB 2617

Arbitration is a form of alternative dispute resolution which is designed to resolve disputes outside of the traditional court system. Typically, parties agree to this method of dispute resolution at the time of entering into a contract with one another. Contracts employing “mandatory arbitration,” whereby the parties give up their right to sue in a traditional court proceeding, have become increasingly popular as many individuals and companies view this process as faster and less costly than traditional litigation.

Under Assembly Bill No. 2617² (Assembly Bill will hereinafter be referred to as “AB”), the use of a mandatory arbitration provision is being limited in such a way that a company may not require that any person, employee or business sign a mandatory arbitration agreement that waives a party’s right to sue via a judicial forum regarding a claim for alleged violation of certain civil rights statutes.³ The civil rights statutes referenced prohibit among other things, discrimination and harassment based on sex, race, color, religion, ancestry, national origin, disability, or medical condition. Instead, AB 2617 requires that any agreement to arbitrate, thus waiving a legal right under Civil Code sections 51.7, 52, or 52.1, must be knowing and voluntary, in writing, and expressly not made as a condition of entering into a contract or as a condition of providing or receiving goods and services. AB 2617 places the burden of proving that the arbitration agreement or waiver was entered into knowingly and voluntarily, and not made as a condition of the contract, on the person attempting to enforce the arbitration agreement or waiver.

This new law became effective as of January 1, 2015, and applies to all contracts entered into, modified, renewed or extended on or after that date.

¹ <http://sacramento.cbslocal.com/2014/12/28/more-than-900-new-state-laws-hitting-the-books-in-2015/>.

² AB 2617 amends California Civil Code Sections 51.7, 52 and 52.1.

³ The civil right statutes cited include the Ralph Civil Rights Act which prohibits “violence or threats of violence” based on an individual's race, color, religion, ancestry, age, disability, sex, sexual orientation, political affiliation, or position in a labor dispute (California Civil Code section 51.7); and the Tom Bane Civil Rights Act which forbids anyone from "interfering by force or by threat of violence" with another's federal or state constitutional or statutory rights. (California Civil Code section 52.1.).

2. Disparaging Online Reviews – AB 2365

New law AB 2365,⁴ commonly referred to as the “Yelp” bill, provides that a “contract or proposed contract for the sale or lease of consumer goods or services may not include a provision waiving the consumer’s right to make any statement regarding the seller or lessor or its employees or agents, or concerning the goods or services.” The new law goes on to state that it will also be unlawful to threaten, seek to enforce, or to “otherwise penalize” a consumer for making any such statement. Drafters of the bill cited increased use of non-disparagement clauses in online agreements, and how such clauses limit a consumer’s free speech, as the impetus for drafting this rule.

Violations of this rule involve significant penalties, beginning at \$2,500 for the first violation, \$5,000 for each subsequent violation and \$10,000 for a “willful, intentional or reckless” violation. While the intent of the new rule is clear, it is unclear just how far reaching its application will be. For instance, the rule does not provide guidance as to what it means to “otherwise penalize” a consumer for making a disparaging remark. Further, the rule does not cite any geographic limitations, and as such, out-of-state businesses conducting business in the state of California are likely required to follow this rule as well.

3. Defining Nonprofit Directors’ Voting Rights – AB 2755

California’s Nonprofit Corporation Law (“NCL”), among other things, regulates the organization and operation of nonprofit public benefit corporations, nonprofit mutual benefit corporations, and nonprofit religious corporations.⁵ AB 2755 is designed to clarify the meaning of “director” within the NCL. Pursuant to Cal. Corp. Code § 5047, a “director” includes “natural persons, designated in the articles or bylaws or elected by the incorporators, and their successors and natural persons designated, elected or appointed by any other name or title to act as members of the governing body of the corporation.”⁶ The new rule however specifically states that a “director” does not include a person who does not have the authority to vote as a member of the governing body. Thus, unless the Articles of Incorporation or bylaws of a corporation specifically limit the person’s right to vote as a member of the governing body, under the new rule, the person so designated will be a “director” for all purposes. This is of particular importance to those corporations who designate natural persons a director by reason of his or her position (such as an *ex officio* member⁷) as such individuals will be granted full powers and voting rights of directors unless specifically stated otherwise in the company’s bylaws.

4. Taxes for Foreign Nonqualified LLCs – AB 1143

A limited liability company (“LLC”) is a business entity structure that combines the pass-through taxation of a partnership or sole proprietorship, with the limited liability of a corporation. LLCs organized within California are termed “domestic,” while companies

⁴ Cal. Civ. Code § 1670.8(a)(1).

⁵ http://leginfo.ca.gov/faces/billNavClient.xhtml?bill_id=201320140AB2755.

⁶ Cal. Corp. Code § 5047.

⁷ An *ex officio* member is a member of a governing body (i.e., board of directors, committee, council, etc.) who is part of that governing body by virtue of her holding another office. For example, a corporation’s bylaws often provide that the organization’s president will be *ex officio* a member of all committees.

organized outside California are termed "foreign." Additionally, LLCs that are registered with the California Secretary of State ("SOS") are termed "qualified," while companies that are not registered with the SOS are termed "nonqualified."

Prior to its revision, the Revenue and Taxation Code⁸ required that all domestic and foreign qualified LLCs - classified as partnerships or disregarded entities, file California Form 568 "Limited Liability Company Return of Income."⁹ An LLC required to file Form 568 must pay an annual tax of \$800 and may be subject to an LLC fee based on its total income derived from, or attributable to, the state of California. Failure to file a tax return or pay taxes can result in serious penalties including suspension or forfeiture of the LLC's registration. Moreover, any contract entered into by the LLC may be voided by the other party to the contract during the LLC's suspension or forfeiture period.

Drafters of the current rule however created a "loophole" in the language by failing to include "foreign nonqualified LLCs" (i.e., LLCs that are not registered with the California SOS). New rule AB 1143 amends the Revenue and Taxation Code thus closing the loop by including foreign nonqualified LLCs, subjecting them to tax filings and contract voidability repercussions.

Conclusion

The items discussed above are by no means an exhaustive list of new laws that may impact California businesses. The information herein is intended to encourage California-based businesses and out-of-state-businesses with employees in California or conducting business in California, to review all new laws in tandem with their policies, procedures and practices to ensure compliance. For more information on these and other considerations, please contact us at info@jackolg.com, or (619) 298-2880. Also, please visit our website at www.jackolg.com.

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⁸ Such information is found in Sections 402.5, 23038, 23304.1 and 23305.5 of the Revenue and Taxation Code.

⁹ http://www.leginfo.ca.gov/pub/13-14/bill/asm/ab_1101-1150/ab_1143_cfa_20130429_150650_asm_comm.html.