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WHERE TO LLC? PERHAPS NOT CALIFORNIA

THE STATE HAS RECENTLY REVISED ITS LLC LAWS,
MAKING THINGS TOUGHER FOR PRODUCERS

Regardless of where you choose to shoot your film, the first question for a producer is where to create your production entity. Producers often create a single-purpose production entity (usually a limited liability company, or LLC) in one state, but shoot or do business in another. Traditionally, California has been a top choice for producers from all over the nation because of certain advantages. For example, the federal courts in California are more protective of producers when interpreting federal copyright laws. And California's statutory framework ensures that child actor contracts cannot be voided by the child or parent.

As of 2014, though, producers might want to look elsewhere to set up shop. In January, California enacted a new comprehensive law governing LLCs. The law was supposed to bring California more in conformity with the "model LLC statute" adopted by most other states, but legislators couldn't resist putting their fingerprints all over it. The result? California LLCs are even further out of step with every other state than before, and the new cons may trump the former pros. Here are two examples.

For one, "managing members" of LLCs (i.e. a film's producers) have traditionally been protected by the business judgment rule. This provides that as long as producers act within their sound business judgment and in good faith, they cannot be penalized for bad decisions. But the new California law has strengthened certain "duty of care" obligations on managing members, and

places an emphasis on obtaining disclosures and written informed consent for a number of actions. The laws of most other states do not require written consent, or they allow it to be waived at the time the LLC is created by express terms set forth in the operating agreement. (Note that officers in corporations can still obtain broad waivers built into corporate bylaws.)

If the informed consent requirements are applicable to a certain action and an investor shows those requirements were not met, then the investors may be able to hold the LLC and its producers accountable in a lawsuit. In the past such scrutiny was not permitted. How much information is enough to constitute "informed consent?" To some extent, the new law leaves that up to the courts to decide, and until the definition is more clearly developed, test cases may be plentiful.

Secondly, suppose your friend is an investor holding a small minority share of ownership in your LLC. He becomes indebted to some third party. That debt collector then obtains a judgment against your friend. Under the new law, the debt collector can become the new owner of the interest that your friend once held in your production company. That debt collector might then demand to be cashed out in an amount equivalent to the percentage share once held by your friend, or to compel a sale of assets sufficient for the LLC to pay your friend's debt off (at least to the extent of the value of that ownership interest). The debt collector would not be able to do this if the entity was created under Nevada LLC laws, for example, or if the

entity was created as a California corporation.

If you are an existing California LLC created before 2014, speak with your counsel to determine whether the new California law applies or whether you are grandfathered into the old

law. Commentators disagree on this issue and different facts may be determinative. The advice an attorney gave last year may be different than the advice given this year, even when all aspects of what the company is trying to achieve are the same. Also, note that even if you organize your LLC in a different state to stake claim to their laws, you still need to register to do business in California if the company engages in business in California (i.e. California will collect a tax).

Remember the words of the *Diff'rent Strokes* theme song from the '80s: "What might be right for you, may not be right for some." Deciding what type of entity to create to serve as your production company should not be made hastily. Just because a fellow movie-maker made a certain choice doesn't mean that it's the right decision for your production. If ties to California are important for your film, alternatively choosing to be a California corporation instead of a California LLC may now be a preferred approach.

Many issues remain untested and are continually evolving. There is already a "clean up bill" in the works in the California legislature to correct and clarify aspects of the new law— but until then, be cautious. **MM**

