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BKCG
BURKHALTER KESSLER CLEMENT & GEORGE LLP

Should I Form My New Business Entity Outside California?

As a business lawyer, this is a question I get asked a lot by my clients, almost all of whom are operating, or plan to operate, a business, here in California. While the answer to this question is, of course, dependent on the specifics of the business that the new entity will conduct or is conducting, there are some principles of general applicability. There are also a few common myths on this subject which need to be dispelled. This article was previously published during COVID-19, in 2020, but is as relevant today as it was then.

1. If your entity is "transacting intrastate business" in California, it must be qualified to do business here, irrespective of where it is incorporated.

Many business owners are led to believe that, because Delaware is, rightly, considered to have the most sophisticated set of corporate laws in the United States, they should form their new entity there. It is also true that Delaware has a dedicated business law court, the Delaware Court of Chancery, which, to quote the Delaware Courts website, "is widely recognized as the nation's preeminent forum for the determination of disputes involving the internal affairs of…Delaware corporations and other business entities." Similarly, other people decide to form their entities in Nevada, for example, because Nevada has no state income tax, or in Wyoming, because they have heard that Wyoming entities afford greater privacy about entity ownership[1]. However, the practical realities are rather more complicated than that. What many people fail to understand is the fact that if an entity is "transacting intrastate business" in California[2], the entity must register with the California Secretary of State and obtain a "Certificate of Qualification" under Corporations Code § 2105.

This process, whilst straightforward, involves appointing an agent for service in California and providing an annual list of either statutory officers for a corporation or, for a limited liability company, a bi-annual list of at least one manager (or a member, if the LLC is member-managed). Thus, any apparent advantage of total anonymity that might be obtained by incorporating outside California disappears as soon as the entity registers to do business as a foreign entity in California.
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[1]California does not require entities to disclose the identities of its owners in a publicly available document, except that if an LLC is member-managed LLC, the bi-annual Statement of Information requires the name and address of at least one member-manager to be listed.
[2]Meaning, for example, that the entity has a physical location, employs people, or regularly engages in business transactions in California, including engaging in a large volume of internet sales with California residents.

Congratulations To Daniel J. Kessler On His Admission To ABOTA

Daniel J. Kessler was voted in as a new member of the American Board of Trial Advocates (ABOTA) at the National Board Meeting in Banff, Canada, on Saturday, July 12, 2025. This is a prestigious and exclusive invitation-only membership based on high personal character and honorable reputation. We are proud to now have two ABOTA lawyers at BKCG. Alton G. Burkhalter, who has been a dedicated member since 2019, exemplifies the standard of excellence the organization represents. Daniel's election builds on that tradition and further strengthens our firm's commitment to trial advocacy at the highest level.

Congratulations To Daniel J. Kessler and Michael Oberbeck!

Daniel J. Kessler and Michael Oberbeck obtained one of the Top 10 Bench Awards in all practice areas in California for 2024 with a $6,091,781.00 award in the Orange County Superior Court case entitled *GF Distribution, Inc., et al. v. Shelf Life Inc., et al.*, Case No.30-2020-01162750-CU-BC-CJC.

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California registration also brings with it the obligation to file annual state tax returns for the entity in California and for the entity or its owners (depending on the entity's tax treatment) to pay California income tax on income deemed earned in California. Bear in mind that the entity will have similar obligations plus, typically, an annual registration or franchise tax-type fee, and thus a duplication of expense, in the state of incorporation, whether it is actually transacting business there or not. Nevada, for example, charges an annual fee (for filing an annual report plus a business license fee) of $650 per calendar year. In addition, California residents who are equityholders in a non-California entity cannot escape California income tax liability simply because the entity is not incorporated in California.

One of the penalties of not obtaining a Certificate of Qualification when one is required is an entity's inability to prosecute or defend a lawsuit in California until the Certificate is obtained, which is obviously not a good thing. It should also be mentioned that an entity's jurisdiction of formation may, practically speaking, have little or no impact on the ability of the entity's judgment creditors to seize assets of the entity located in a state in which the creditor has a judgment, for example, by garnishment or foreclosure. Judgment enforcement laws apply in the state in which the judgment debtor's assets are physically located, and not where the entity is incorporated.

2. California corporate law may apply to a foreign corporation that conducts more than half of its business in California. In the past, several clients have told me that they wanted to incorporate outside California so that, for example, they could avoid certain aspects of California corporate law that would be inconvenient to them, such as the "corporate opportunity doctrine", which forbids corporate fiduciaries from appropriating new business prospects for themselves without first offering them to the company. Unfortunately, one of California's so-called long-arm statutes, Section 2115 of the California Corporations Code, subjects foreign corporations to California corporate law on a large number of issues, if they conduct more than half of their business in California, based on an averaging of three criteria, namely property, payroll, and sales; or if more than half of their outstanding voting securities are held by persons with a California address. The areas of California corporate law that will apply (as far as any corporate legal dispute brought in California court is concerned), rather than the laws of the entity's state of incorporation, include such things as removal of directors, filling of director vacancies where less than a majority in office elected by shareholders, directors' standard of care, indemnification of directors and officers, and supermajority vote requirement and limitations on sale of assets. Thus, as just described, forming a corporation outside California in an attempt to benefit from more favorable corporate laws elsewhere may well be futile if the corporation transacts the majority of its business in (or from) California.

3. For commercial real estate ownership, consider incorporating where the property is located. Generally speaking, the rental of real property, whether a single-family residence, apartment building or commercial property is considered engaging in intrastate business in the state where the property is located, requiring the owner entity (usually an LLC) to register to do business, report income and to file tax returns in that state. For that reason alone, it makes sense to first consider forming the LLC in that state, unless there are compelling reasons not to do so. For non-California residents in particular, due to the aggressiveness of California's Franchise Tax Board, it makes sense not to utilize a California LLC to own commercial real estate located outside California but, at a minimum, California residents will avoid duplication of entity expense and red tape by using a non-California entity to hold title to real property located outside California.

4. Very often, the theoretical advantages of incorporating outside California are outweighed by the practical disadvantages. There can be no question that, for certain entities and in certain industries and circumstances, incorporating outside California, especially in Delaware, may be desirable, even if the company is based in California. For example, many venture capital firms and angel investors prefer that startups incorporate in Delaware, and investment bankers may advise incorporation (or reincorporation) in Delaware for companies that intend to go public. However, in my experience working with hundreds of California-based small to mid-size companies, the touted advantages of being incorporated outside California were either nonexistent or illusory. In many cases, the inconvenience and expense of having to file multiple state tax returns, appoint multiple agents for service and even seek legal advice from corporate lawyers qualified to practice law in their entity's state of incorporation (as happened to a client recently whose corporation was incorporated in Wyoming), etc. actually made our client regret having formed an entity outside California. If your entity has a relatively small number of shareholders or members all of whom reside in California, and is not intending to go public, the sophisticated corporate laws and courts of Delaware may simply never be of any applicability to you.

5. Reincorporating a non-California entity in California is a possibility. If you have formed a non-California entity and wish you had not, assistance may be at hand, California does permit foreign business entities to convert into a California entity such as a corporation or an LLC, provided that the conversion is permitted under the laws of the jurisdiction of the foreign business entity. This is a pretty quick, easy and inexpensive process and BKCG has assisted a number of clients with such conversions. The converted company retains its Employer Identification Number, and new California entity documents are prepared for the converted entity. California also now allows both California corporations and LLCs to convert to non-California entities.

Please note, that this article is intended to be general in nature and should not be interpreted as legal advice applicable to your entity. Ultimately, a decision on where to incorporate a new entity may be driven by such factors as tax issues; an intention to relocate the business and/or its owners outside California; the non-California residence of co-owners; the non-California source of entity income; or complex asset protections considerations, all of which are beyond the scope of this article. As always, you should seek advice based on your particular situation before making this or any other legal decision.

Please contact Greg Clement at gclement@bkcglaw.com or call (949) 975-7586 if you have any questions about any issue discussed in this article, or any corporate law matter.

California Adopts First-In-The-Nation Rules On Employers' Use Of AI In Hiring: What You Need To Know

So, you are not exactly sure what Artificial Intelligence (AI) is or how it works, but another colleague asks why your business is not taking advantage of it and confidently informs you that the gap between you and your competitors will only widen exponentially until you start using AI. You have ruled it out before, but are now reconsidering if only to demonstrate to your clients that your company is keeping up with the times. You hesitantly respond with, "LLM?," a buzzword you know is linked to AI but are equally unsure of. For all you know, a LLM is some sort of degree that ChatGPT must earn before stealing jobs.

That's it. You bite the bullet, take your colleague's advice, and rashly tell your IT team to sprinkle some AI into your hiring practices to enable you to find and hire better candidates. Perfect, you think. Not so fast. In a year or so, you find yourself defending against lawsuits alleging discriminatory AI employment practices that bring nothing but stress, expensive legal bills, and potential exposure under the Fair Employment and Housing Act (FEHA). This is not what you envisioned.

Before you know it, what started as a well-intentioned but hasty attempt to modernize your hiring process turns into a cautionary tale. Without clear guidelines or a full understanding of how AI systems operate–or how they should be deployed in a legally compliant way–you've inadvertently opened the door to regulatory scrutiny.

On March 21, 2025, the California Civil Rights Council (CRC) approved the final "Proposed Employment Regulations Regarding Automated-Decision Systems" – or Regulations – under the FEHA which become effective on October 1, 2025. The Regulations are the product of the CRC's growing concern that more and more employers are using AI to automate employment decisions in recruiting, hiring, and promoting.

The Regulations define automated decision-making systems (ADS) as a system that may be derived from AI that performs a "computational process that makes a decision or facilitates human decision making regarding an employment benefit…" Some examples provided in the Regulations include:

- Using computer-based tests, puzzles, or games to make predictive assessments about, or measure the skills or abilities of, an applicant or employee;
- Screening resumes for particular patterns; and
- Analyzing online interviews for facial expressions or word choice.

Importantly, an employer's use or implementation of ADS by itself is not unlawful. Under the Regulations, it is unlawful for an employer to use ADS that discriminates against applicants or employees based on FEHA-protected categories (i.e., race, religion, sex/gender, etc.). The Regulations urge employers who use ADS in this context to proceed with caution to avoid discriminatory practices. In addition, the Regulations require employers to preserve their ADS data and related files for four years, beginning on the data's creation date or on the date an applicant/employee action using ADS was made.

The Regulations fall silent on any specific safeguards to ensure compliance, as would be expected given the rapidly developing field of AI. However, like all employment practices, employers should consult with their legal counsel to ensure that their employment practices, including those using ADS, are not discriminatory under California law.

Before haphazardly implementing or using ADS, employers should:

- Conduct regular audits of any AI or ADS used in employment decisions;
- Ensure human oversight is part of any automated hiring process;
- Retain ADS-related data as required by the new regulations; and
- Seek legal guidance before implementing any AI-driven tools.

If your company is considering or currently using AI in employment decisions, contact our team to ensure your systems align with California's evolving legal landscape.

Please contact Joshua Malter at jmalter@bkcglaw.com or call (949) 975-7500 if you have any questions about any issue discussed in this article, or any other related matter.

Score One For The Majority – At Last?

In a decision that surprises no one, the United States Supreme Court has made it easier for majority-group workers to pursue "reverse" discrimination lawsuits under Title VII. In *Ames v. Ohio Department of Youth Services*, a decision that was published on June 5, 2025, the Supreme Court ruled that majority-group plaintiffs claiming employment discrimination under Title VII do not need to show "background circumstances" to support their claim. This decision essentially removes a hurdle that previously made it harder for majority-group workers (like straight, white, or male employees) to prove discrimination, potentially leading to more lawsuits and increased scrutiny of diversity, equity, and inclusion (DEI) initiatives.

The case involved Marlean Ames, a heterosexual woman, who alleged that the Ohio Department of Youth Services denied her a promotion because of her sexual orientation, selecting a gay candidate instead. At issue was the Sixth Circuit's heightened "background circumstances" pleading standard for so-called reverse discrimination cases, which required a majority-group plaintiff to show that the employer was the "unusual employer who discriminates against the majority." This standard created a circuit split, with four other circuits (Seventh, Eighth, Tenth, and DC Circuits) applying similar burdens to majority-group plaintiffs and the remaining circuits not requiring a heightened pleading standard.

The court rejected the "background circumstances" rule, which required majority-group plaintiffs to demonstrate evidence suggesting the employer was an unusual discriminator against the majority. Justice Jackson wrote the opinion, noting that Title VII does not distinguish between majority- and minority-group plaintiffs and rejecting the Sixth Circuit's rule as inconsistent with the statute's focus on individual protections. "Congress left no room for courts to impose special requirements on majority-group plaintiffs alone," wrote Justice Jackson. The decision reaffirms that Title VII's protections apply equally to all employees, regardless of their group membership.

Though the case did not directly concern corporate diversity, equity, and inclusion (DEI) programs and initiatives, Justice Thomas did not miss his chance to shoot his shot, writing in a concurring opinion that "American employers have long been 'obsessed' with 'diversity, equity, and inclusion' initiatives and affirmative action plans. Initiatives of this kind have often led to overt discrimination against those perceived to be in the majority."

The *Ames* decision simplifies the pathway for majority-group plaintiffs to file claims under Title VII and will surely lead to even more employment litigation in California. Employers committed to fostering inclusive workplaces may continue to pursue a range of thoughtfully designed, lawful programs and practices but should regularly assess such programs and practices in light of the volatile legal and political landscape we have chosen for ourselves.

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Selling Customer Property To Cover Cost Of Work And Service Rendered

Frequently, businesses provide services which require the customer to leave personal property under the care and control of the business. This can put a service provider in a difficult position because services must be rendered with the expectation that the customer will return to pay and retrieve their property. For example, a dry cleaner must expend the resources to launder clothes prior to collecting payment. If the customer fails to retrieve his or her garments, the business takes a loss.

Luckily, there are statutory remedies that protect business owners from the liabilities posed by non-returning or non-paying customers. California Civil Code Section 3051 and 3052 state that where property is rendered for service, the service provider has a lien granting authority to sell the property to cover the cost of work done and materials furnished; alternatively, the service provider may retain possession of the property until the owner has satisfied payment. Of significance, is that a business or service provider who sells the property may only keep the amount necessary to discharge the debt, cover the cost of maintenance and storage of the property up until its sale, and any costs associated with the sale. Excess money from the sale, if any, must be returned to the owner of the property. The statute is broad and considers a wide array of personal property ranging from garments to live animals, however, there are a few notable exceptions to the kinds of personal property that are eligible for a possessory service or repair lien. The Civil Code specifies that boat vessels, vehicles, manufactured homes, mobile homes, and commercial coaches are not eligible to be sold under Code section 3051 and 3052.

Generally, sale of property may be effectuated ten days after the amount due has gone unpaid by the owner, and only if it was the legal title owner who left the property with the service provider. Furthermore, notice to the original owner is necessary. Generally, notice must be given by posting in a local newspaper printed within the county where the property is located, and the sale must take place by public auction. Should the lien holder be in a region where there is no locally printed newspaper, then the statute allows for notice by placing a posting in the town's three most public places and the location where the property is to be sold. If the property to be sold is a watch, clock, or jewelry piece, then the lien holder must wait a full year *after completion of the work* before providing a necessary 30-day notice to the property owner. Notice for these specialty items may be served by registered mail to the owner's last known address with a return receipt. If the address is unknown, then notice may be posted in two public places within the city or town where the property is located.

If you are a business owner who must maintain possession of personal property in the process of providing service, know that California law protects you from the inherent liability of being an unpaid service provider. If you are a consumer, please ensure that your beloved pet does not overstay its welcome at its next veterinary visit.

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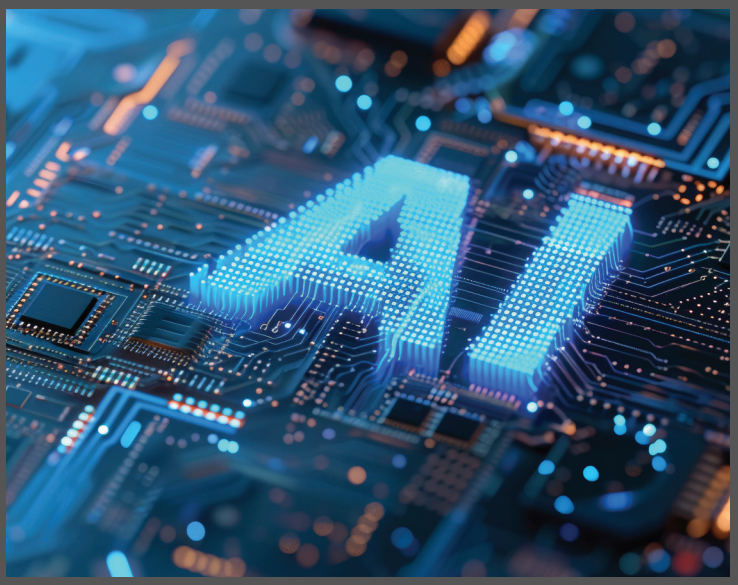
What Is "Fair Use" In The Age Of AI?



There is a lot of talk about artificial intelligence ("AI") in today's media. Authors, actors, and others are concerned that their style or likeness can be replicated by AI to create a multi-billion dollar business and will essentially replace the need for them. After all, if an AI company can digest every book written by an author and then train its chatbot to write in the exact style and format of that author without ever having to pay that author, what will become of the author? The issue was addressed in a recent opinion in *Bartz et al v. Anthropic* (U.S. Dist. Court C 24-05417WHA) and analyzes the question of how large language models ("LLM") can legitimately learn from existing material without violating copyright laws.

Andrea Bartz, a best-selling mystery writer, and several other authors sued Anthropic accusing it of stealing their work to train "Claude," its AI model chatbot. On June 23, the U.S. District Court for the Northern District of California issued an opinion concerning, in part, the question of whether the purchase and scanning of lawfully purchased books in print form into a digital database which is then permanently stored and used to train a company's AI system constitutes "fair use" under the U.S. Copyright law. The Court ruled in favor of Defendant Anthropic that its use constitutes "fair use" under the Copyright Act.

Defendant Anthropic is an AI software firm founded by former OpenAI employees and is backed by Amazon and Google's parent companies. Anthropic downloaded over seven million books in the start of its quest to digitize all the books in the world into one central library. The central library is to be used to train Anthropic's LLMs. Once scanned, the engineers used the books to assemble training datasets for "Claude". When a user prompts Claude with a text, Claude quickly responds with a text that mimics human reading and writing – in this case, in the style of the Plaintiff authors. Claude can do so because Anthropic trained the LLMs that underlie Claude. Anthropic learned that it was best to train the LLMs on works just like the ones that Plaintiff Bartz and the other authors had written – with good factual development, well-organized analyses, and captivating narratives – in a style that essentially mimicked the Plaintiff authors' styles.

To train the LLMs, copies of the scanned books were placed in a central "research library" or "generalized data area". Sets or subsets were copied into training copies for data mixes and training copies were then successively copied into a trained LLM. Plaintiff Bartz and the authors claimed that by reproducing their books to train the LLMs there was a violation of federal copyright law.

Section 107 of the Copyright Act ("Act") sets forth four factors to be evaluated in determining what constitutes "fair use". Under the Act, "fair use" allows for the use of a copyrighted work so long as the use is transformative. Generally stated, transformative uses are those that "add something new, with a further purpose or different characters, and do not substitute for the original use of the work." U.S. Copyright Office Fair Use Index, Copyright.gov, https://www.copyright.gov/fair-use/ (Sept. 27, 2024). The factors to be considered as to what constitutes fair use include: 1) the purpose and character of the use, including whether such use is of a commercial nature or is for nonprofit educational purposes; 2) the nature of the copyrighted work; 3) the amount and substantiality of the portion used in relation to the copyrighted work as a whole; and 4) the effect of the use upon the potential market for or value of the copyrighted work. A court's analysis is based on an "objective" standard as opposed to the "subjective intent" of the user.

In balancing the four factors, the Court ultimately held that Anthropic's use of the Plaintiff authors' books that were purchased and scanned were "exceedingly transformative" and, therefore *did* constitute a "fair use" under the Copyright Act. According to the Court, Anthropic's LLMs, trained upon the authors' works, were not to race ahead and replicate or supplant those works – but to turn a hard corner and create something different."

Importantly, the Court stated that the Plaintiff authors did not claim that the training led to "infringing knockoffs", with replicas of their works being generated for users of Claude. If Plaintiff authors had made such a claim, "this would be a different case." However, Anthropic using the authors' works to train its LLMs to simply write in the authors' style and format was, under this Court's opinion, acceptable. Defendants like Anthropic and other AI companies now have a path to use the "fair use" defense as AI marches forward.

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Hiring The Attorney You Want Matters

Since even before the founding of this country, it has been a widely held belief that an independent judiciary is a vital check on the power of the other two branches of government. To accomplish such an important task, the judiciary requires the participation of independent attorneys who are free to zealously advocate for their clients' interests without fear of reprisal from the government. In fact, zealous advocacy is a bedrock principle of legal practice.

In 1788, James Madison, one of the founding fathers and widely considered the "Father of the Constitution", wrote in The Federalist Papers No. 47 that: "The accumulation of all powers, legislative, executive, judiciary, in the same hands, whether of one, a few, or many, and whether hereditary, self-appointed, or elective, may justly be pronounced the very definition of tyranny." It is the role of the judiciary to provide this vital check on tyranny, a truly impossible task without independent attorneys.

Separation of powers is in many ways the cornerstone of our entire system of government, which simply does not function without a judiciary that is willing and able to challenge the other branches of government. This natural ebb and flow between the branches of government is one of the truly awe-inspiring elements of our government, and one of the features that has permitted it to last so long: when one branch oversteps the mark, the other branches have been able to push back, with varying degrees of success. This magical dance simply must be allowed to continue. It has at times been messy, and will continue to be so, but it has worked for more than 200 years.

On March 6, 2025, President Trump issued Executive Order 14,230. In the opening paragraph, the Order makes crystal clear its purpose: taking punitive actions against Perkins Coie LLP due to the firm's representation of Hillary Clinton's 2016 presidential campaign, most specially the creation of the so called "Trump Dossier." The punitive actions included suspending the security clearance of any individual employed by Perkins Coie pending a review, terminating any federal contracts which the government had entered into with Perkins Coie, and prohibiting access to federal buildings to employees of Perkins Coie.

This very public action has not gone unnoticed within the legal community. It has created a situation whereby opponents of the current administration are finding it increasingly difficult to secure legal representation, with many firms claiming conflicts of interest. A legal professional fearful of representing clients who may be in disfavor of any president is a legal profession which simply cannot function in providing the zealous advocacy needed so that the judiciary may justly resolve disputes and provide an appropriate check on the power of the legislative and executive branches.

Our firm is not one with top secret security clearances, federal contracts or representation of political figures and we take no position regarding the political issues in dispute. However, it matters not which party controls the levers of power in Washington, D.C. No president should be permitted to take punitive actions against attorneys simply for the act of representing clients in opposition to that president.

When you are seeking zealous and qualified legal representation, you do not want your attorney to be fearful of agreeing to represent you due to possible reprisals by the government. Potential clients should be free to hire the attorney of their choice and no attorney should be placed in the position of having to decline representation based on the identity of the potential client, or accept the representation and risk being punished as a result. Anything less runs contrary to our country's deep-seated and most precious principles of liberty and justice for all.

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Burkhalter Kessler Clement & George LLP (BKCG) advises and protects businesses and high net worth individuals through experienced litigation and transactional lawyers. Core practice areas include: Business litigation in state and federal courts, as well as FINRA, AAA and JAMS arbitration and mediation; Corporate, transactional and employment law documentation; and Estate Planning and Probate services through the Firm's State Bar certified Estate Planning Specialist.