

Date of Hearing: May 3, 2010

ASSEMBLY COMMITTEE ON BANKING AND FINANCE
Mike Eng, Chair
AB 2158 (Hagman) – As Amended: April 22, 2010

SUBJECT: Corporations.

SUMMARY: Makes changes to a closely held corporation formed and organized that may elect to be a close corporation. Specifically, this bill:

- 1) Reorganizes the Corporations Code applicable to close corporations into a separate chapter.
- 2) Replaces the term "close corporation" with "statutory close corporation."
- 3) Revises the number of persons who are shareholders of record to conform more closely to the S corporation rules. An S corporation, is a corporation that makes a valid election to be taxed under Subchapter S of Chapter 1 of the Internal Revenue Code.
- 4) Authorizes a close corporation to eliminate or dispense with the general requirement of a board of directors while it has statutory close corporation status.
- 5) Provides that a close corporation would not have the power to have more shareholders of record than the statute allows and the close corporation's status would terminate only as the result of an amendment to its articles.
- 6) Allows shareholders to agree that one shareholder or shareholders with less than 50% of the voting power could elect to dissolve voluntarily.
- 7) Provides that shareholders would be able to agree that more than one shareholder could be required for standing to petition for involuntary dissolution.
- 8) Deletes the sunset date that provides that "all members of the board" includes an "interested director" or a "common director" who abstains in writing from providing consent if specified disclosures have been made to certain directors, the disclosures are included in the written consent, and these directors approve the action by a specified vote.

EXISTING LAW

- 1) Defines a "close corporation" as a corporation whose articles contain a provision that all of the corporation's issued shares of all classes shall be held of record by not more than a specified number of persons, not exceeding 35, and a statement "This corporation is a close corporation." [Corporations Code Section 158]
- 2) Provides that a close corporation ceases to be a close corporation upon the filing of a specified amendment to its articles or under certain circumstances as a result of a specified transfer of share. [Corporations Code Section 158]

- 3) Provides any attempted voluntary inter vivos transfer of the shares of a close corporation resulting in the number of holders of record of its shares exceeding the maximum specified in the articles is void if the certificate contains a specified legend. [Corporations Code Section 158]
- 4) Establishes that an involuntary dissolution of a close corporation requires a verified complaint to be filed by any shareholder of a close corporation. [Corporations Code Section 158]

FISCAL EFFECT: Although deemed non-fiscal, this measure may bring unintended costs absorbed by the SOS's office.

COMMENTS:

AB 2158 seeks to organize the Corporations Code related to close corporations by moving the subject into a separate chapter and changing "close corporations" to "statutory close corporations." The new section would be added to the Corporations Code, Chapter 24, commencing with Section 2400, titled Statutory Close Corporations. Statutory close corporations status is available for professional corporations organized under the Moscone-Knox Professional Corporation Act.

In addition to consolidating the close corporation code sections into one chapter, this bill makes other changes including:

- 1) Providing that a corporation would not have the power to issue shares or to register a transfer of shares that would cause the number of shareholders or record to exceed its maximum permitted number and requiring all outstanding shares of the corporation to be certificated.
- 2) Expanding the counting rules for determining the number of persons who are shareholders of record which would make California law more similar to an S corporation as defined under the Internal Revenue Code (26 U.S.C 1361) which is a corporation that has elected to be taxed like a partnership, much like the statutory close corporation is an election by a corporation to be governed like a partnership.
- 3) Providing a mechanism for the shareholders to restrict or eliminate any of the expanded counting rules to further limit the number of persons that may be shareholders of record.
- 4) Requiring the legend on the certificates representing shares of a statutory close corporation to be "on the certificate" rather than "on the face."
- 5) Requiring a corporation to provide to any shareholder, upon request and without charge, copies of the articles, bylaws, and any shareholders' agreement on file with the corporation.
- 6) Adding to the list of expressly permitted deviations from general corporate law that shareholders of a statutory close corporation may, in a shareholder's agreement, agree to eliminate or dispense with the general requirement of a board of directors.
- 7) Expressly providing that any agreement to eliminate or dispense with the board must be effectuated by a statement in the articles.

- 8) Expressly providing that termination of statutory close corporation status would not affect the rights of shareholders under any other agreement or the articles or bylaw unless prohibited by law.
- 9) Authorizing that shareholders of a statutory close corporation to agree that as few as one shareholder, or shareholders with less than 50% of the voting power, could elect to dissolve. Requires notice to all other shareholders and commencement of wind up and liquidation within 31 days.

ARGUMENTS IN SUPPORT: According to the sponsor, the Business Law Section, Corporations Committee, of the California State Bar, "provisions that specifically apply to close corporations were enacted as a part of the broad adoption of the General Corporation Law of 1975. These provisions are scattered throughout the Corporations Code, making the rules governing these corporations difficult to find."

According to the Sponsor, the reorganization of the Corporations Code will allow statutory close corporations to work more efficiently and effectively.

ARGUMENTS IN OPPOSITION: According to the opposition, Secretary of State, Debra Bowen, AB 2158 does not address what the statement of information, filed with the Secretary of State's office, should include if the shareholders eliminate the Board of Directors.

Current law requires corporations to file a statement of information with the SOS's office listing the entity's address, the name and address of the agent for service of process and the name and address of the principals of the entity, which includes the Board of Directors. The names and addresses of the principals of a corporation are used by enforcement and taxing agencies, banks and the general public to validate individuals acting on behalf of a corporation, as well as for contacts and for legal process. Under AB 2158, this information is not provided when the Board of Directors is eliminated, so enforcement and taxing agencies, banks and the general public will have no or limited ability to take action against a corporation.

The SOS's office is recommending amendments to require judicial dissolution in all instances for statutory close corporations, or to specifically address the certificate of dissolution when the shareholders have eliminated the board of directors.

Current law requires a certificate of dissolution to be filed for a voluntary dissolution which is required to be signed by a majority of directors in office. AB 2158 may cause confusion by allowing the board of directors to be eliminated by the shareholders with the potential outcome that the required signatures could not be provided and the corporation could not dissolved.

REGISTERED SUPPORT / OPPOSITION:

Support

Business Law Section, State Bar of California (Sponsor)

Opposition

Secretary of State, Debra Bowen

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