

Date of Hearing: January 10, 2022

ASSEMBLY COMMITTEE ON BANKING AND FINANCE

Timothy Grayson, Chair

AB 1381 (Gallagher) – As Amended January 5, 2022

SUBJECT: Limited liability companies: statement of information: Secretary of State: notice

SUMMARY: This bill requires the Secretary of State (SOS) to notify a limited liability company (LLC) when an updated Statement of Information (SOI) for that LLC has been delivered for filing. Specifically, **this bill:**

- 1) Requires the SOS, by January 1, 2024, to create and implement a procedure to send a notice to an LLC or foreign LLC that an updated SOI has been delivered for filing.
- 2) Requires the SOS to send this notice to the mailing address or electronic mail address that was previously on file in its records prior to the submission of the updated SOI. The SOS may send this notice either before or after the updated SOI has been filed.
- 3) Removes obsolete language regarding the operative date of Corporation Code Section 17702.09, which this bill amends.

EXISTING LAW:

- 1) Requires an LLC or foreign LLC to deliver to the SOS an SOI containing certain information, including the name of the company, the name and street address of the company's agent. The LLC must submit this information within 90 days after the filing of its original articles of organization or registration and biennially thereafter (Corporation Code Section 17702.09).
- 2) Authorizes an LLC or foreign LLC to file a new SOI whenever any of the required information changes. This new statement supersedes any previously filed statement (Corporation Code Section 17702.09).

FISCAL EFFECT: Unknown. This bill is keyed Fiscal by Legislative Counsel.

COMMENTS:

1) PURPOSE

According to the author:

AB 1381 would provide an extra layer of protection from fraud for LLC members who file a Statement of Information with the Secretary of State. The bill would require a simple notification from the Secretary of State to the original Statement of Information filer so they can take action if any suspected fraudulent activity has taken place within their LLC.

2) BACKGROUND

As part of its duties, the SOS processes and maintains information on business formations and business terminations. The SOS manages more than 250 types of filing documents, including the Statement of Information (SOI), which identifies the key individuals running a business. Generally, a company files a new SOI whenever any of the required information changes, and this new SOI supersedes any previously filed statement. A business often uses the SOI to open bank accounts, enter into contracts, and to otherwise verify the legitimacy of the company.

The process to submit an SOI and other documents to the SOS has undergone significant changes in recent years. Historically, antiquated systems and workload challenges led to long processing times and delays for businesses submitting forms and documents. According to the Department of Finance, processing times, at their peaks, were more than 90 calendar days for SOI filings. In response to this, the SOS initiated the California Business Connect (CBC) project, which aims to update and modernize online services for business filings and requests for information. Thus far, the CBC has led to the following online programs:

- LLC Statements of Information, implemented on 6/21/2017
- Trademark Registration, implemented on 1/11/2018
- LLC Formations, implemented on 5/8/2018
- LLC Terminations, implemented on 12/27/2018
- Trademark Modifications, implemented on 10/8/2019
- Corporation Statements of Information, implemented on 11/6/2019
- Corporation Formations, implemented on 3/27/2020
- Certificates of Good Standing Orders, implemented on) 6/30/2020 3,028
- Uniform Commercial Code, implemented on 7/15/2020¹

3) WHAT PROBLEM DOES THIS BILL ADDRESS?

This bill seeks to address a situation where a person files a false SOI as part of an effort to sell or borrow against an LLC's real property. As the California Land Title Association (CLTA), this bill's sponsor, notes, many lenders and other interested parties do not realize these documents are not tamperproof and therefore rely on this information to verify the legitimacy of an LLC. As a result, a false SOI can play a key role in enabling this type of fraudulent activity to move forward.

In response to an inquiry from the committee, the author's office provided examples of how the SOI process has been misused or manipulated. Typically, the person files a false SOI to identify themselves as a new managing member of an LLC. They then create a fake operating agreement and then sell or borrow against the LLC's real property. During the transaction, they present fake documents, supported by the new SOI, to the escrow officer. In one example provided by the author's office, the acquaintance of the owner of a single-member LLC filed a new SOI to declare that they were the LLC's new sole manager. During that

¹ Source: Department of Finance.

time, this individual attempted to borrow several hundreds of thousands of dollars against a large tract of undeveloped property using false documents.

As the author's office notes, these cases would have been quickly resolved if the original parties listed on the prior SOI were notified that an updated SOI was filed.

4) RECENT AMENDMENTS

As noted in Comment #2, the SOS is implementing a large overhaul of its business services systems to make the business filings process more efficient and more user friendly. Given the scale of the CBC project and its sensitivity to additional modifications, the author recently amended the bill to address possible implementation challenges. In earlier versions of this bill, the SOS would have to place a hold on an SOI filing until after the parties listed on the prior SOI were notified of the pending change. This would have required a functionality that the CBC system does not currently have, leading to delays and significant costs.

With the most recent amendments, the SOS may now accept an updated SOI submission while also sending a notice of this new SOI to the relevant parties. This change is intended to provide SOS more flexibility in how it creates and implements this notification process.

REGISTERED SUPPORT / OPPOSITION:

Support

The California Land Title Association (CLTA) is a sponsor of this measure. In its letter of support, CLTA details the following reason for why this bill is necessary:

Most lenders, consumers and other interested parties do not realize that the Secretary of State LLC filings are not tamperproof. In this day and age of privacy advocacy and protections, the assumption is that databases held by governmental and private parties are secure and locked down.

Thus, when interested parties attempt to exercise due diligence by verifying the legitimacy of an LLC via the Secretary of State's online database, they presume the LLC principals they are dealing with are legitimate because the LLC filings –tampered with and modified— reflect that the fraudster is authorized to conduct business on behalf of the LLC.

Such an assumption -- that data held by a governmental agency—is accurate, protected, and reliable is reasonable given the attention placed today upon the importance of identity protection by government and business alike. Ironically, it is this very assumption – that the LLC filings held by the Secretary of State are secure and protected – is precisely what fraudsters rely upon when they modify and upload these filings.

While the issue of LLC fraud is of concern to title companies, they are not the only party harmed by the unscrupulous practice. Rather, the fraudulent filing of LLC documents with the Secretary of State also has broader implications for other businesses and consumers that rely upon the accuracy of those filings, making this a broad consumer protection/identity fraud issue that needs to be addressed.

Opposition

None on file.

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