

HOUSE BILL REPORT

HB 1074

As Amended by the Senate

Title: An act relating to corporations.

Brief Description: Regulating corporations.

Sponsors: Representatives Ludwig, Padden, Appelwick and Johanson.

Brief History:

Reported by House Committee on:
Judiciary, February 2 1993, DP;
Passed House, March 10, 1993, 97-0;
Amended by Senate.

HOUSE COMMITTEE ON JUDICIARY

Majority Report: Do pass. Signed by 17 members:
Representatives Appelwick, Chair; Ludwig, Vice Chair;
Padden, Ranking Minority Member; Ballasiotes, Assistant
Ranking Minority Member; Campbell; Chappell; Forner;
Johanson; Locke; Long; Mastin; H. Myers; Riley; Schmidt;
Scott; Tate; and Wineberry.

Staff: Bill Perry (786-7123).

Background: The current Washington Business Corporations Act was enacted by the Legislature in 1989 and governs the operation of corporations within the state.

Many of the provisions in the act are designed to protect the interests of minority shareholders or shareholders without voting power. The act also controls the relationship between the shareholders and the board of directors and officers of a corporation. In what are sometimes referred to as "closely held" corporations, the stock of the company is owned by a relatively small number of shareholders. Examples of closely held corporations range from family businesses in which all shares are owned by family members, to joint ventures which are established as corporations in which all the stock is held by other, publicly held, corporations. Many forms of agreements between shareholders have been developed over the years in closely held corporations. These agreements have sometimes been invalidated on grounds that they do not meet the requirements of the business corporations act as to form or

substance. The Washington State Bar Association is recommending the adoption of statutory provisions explicitly validating some forms of shareholder agreements in closely held corporations.

The Professional Service Corporations Act provides special rules for the incorporation of businesses conducted by accountants, architects, doctors, lawyers, or other professionals. The Professional Service Corporations Act provides that if a professional service corporation uses any term in its name that indicates it is a corporation, the name must also include the abbreviation "P.S." or "P.C." The Business Corporations Act, on the other hand, prescribes the naming of business corporations. A business corporation name must contain the word "corporation," "incorporated," "company," or "limited," or the abbreviation "corp.," "inc.," or "ltd."

Another law outside of the Business Corporation Act that affects corporations is the Unemployment Compensation Act. A provision in this law exempts corporate officers from the unemployment compensation law. The unemployment law describes corporate officers by specifically referring to "president," "vice-president," "secretary," and "treasurer." The Business Corporations Act allows a corporation to establish the designation and number of its officers in its bylaws.

The Washington State Bar Association has proposed technical changes relating to the designation of a professional corporation and to the coverage of corporate officers by the unemployment compensation law.

The Business Corporations Act establishes specific criteria for the dissolution of a corporation by action in the superior court. The attorney general may seek corporate dissolution on grounds related to fraudulent incorporation or abuse of lawful authority. A creditor may seek dissolution on grounds of corporate insolvency. A corporation may also have its voluntary dissolution supervised by the court. In addition, a shareholder may seek dissolution on various grounds. These grounds include that the directors are engaged in illegal activity, that the shareholders cannot reach agreement on the election of directors, that irreparable injury will result to the corporation because of a management deadlock, or that corporate assets are being wasted.

Summary of Bill: Generally, a shareholder agreement among the shareholders of a corporation is valid even if the agreement violates other provisions of the Business Corporations Act. This authorization regarding shareholder

agreements is restricted in several ways. These restrictions include:

- o The authorization applies only to corporations whose shares are not listed on a national exchange and are not regularly traded in a market maintained by a national securities association.
- o The authorization applies only to agreements that are signed by all shareholders in the corporation. Unless the agreement provides otherwise, amendments to the agreement must also be unanimous.

Specific examples are provided of the kinds of shareholder agreements that are authorized. A shareholder agreement may do any of the following, even though inconsistent with the rest of the corporations act:

- o Restrict or eliminate the board of directors;
- o Authorize distributions not in proportion to share ownership;
- o Establish directors and officers;
- o Establish voting rights of shareholders and directors;
- o Transfer property or services between the corporation and any shareholder, director, officer or employee;
- o Give to any person the power to exercise all corporate powers and to manage the business;
- o Resolve director or shareholder deadlocks;
- o Set the conditions for dissolution; and
- o Otherwise exercise corporate powers and manage the business in a manner not contrary to public policy.

Rules are established regarding the rights and obligations of subsequent purchasers of shares in a corporation that is subject to a shareholder agreement. Stock certificates of such a corporation must indicate the existence of the agreement. Purchasers without knowledge of the agreement may rescind the purchase.

To the extent that a shareholder agreement transfers the powers of the board of directors to another person, liability for the exercise of those powers is also transferred.

Even if an agreement treats a corporation as though it were a partnership, the agreement is not a ground for imposing personal liability on a shareholder.

Three amendments unrelated to shareholder agreements are also made. First, the corporate name of a professional service corporation must contain either the words "professional service" or "professional corporation" or the abbreviations "P.S." or "P.C." The corporate name may also contain the words "corporation," "incorporated," "company," or "limited," or the abbreviation "corp.," "inc.," "co.," or "ltd." Second, a provision of the Unemployment Compensation Act which identifies corporate officers is amended to conform to the Washington Business Corporation Act's designation of those officers. Third, an additional ground upon which a shareholder may seek the dissolution of a corporation is provided. That ground is that the corporation has ceased all business activity and has failed to dissolve itself within a reasonable time.

EFFECT OF SENATE AMENDMENT(S): The Senate amendment adds a requirement that when a shareholder agreement has limited or dispensed with the board of directors, the names of those persons who are responsible for running the corporation must be listed in the corporation's initial and annual reports.

Fiscal Note: Not requested.

Effective Date: Ninety days after adjournment of session in which bill is passed.

Testimony For: The bill ratifies hundreds of shareholder agreements that have been in place for years, and follows the trend of courts and legislatures across the country.

Testimony Against: None.

Witnesses: P. Cameron DeVore, Washington State Bar Association (pro); and Don Whiting, Secretary of State (pro).

VOTE ON FINAL PASSAGE:

Yeas 97; Excused 1

Excused: Representative Romero