

HOUSE BILL REPORT

SSB 5003

As Passed House:
April 15, 2019

Title: An act relating to Washington's business corporation act.

Brief Description: Concerning Washington's business corporation act.

Sponsors: Senate Committee on Law & Justice (originally sponsored by Senators Pedersen and Padden; by request of Washington State Bar Association).

Brief History:

Committee Activity:

Civil Rights & Judiciary: 3/13/19, 3/22/19 [DP].

Floor Activity:

Passed House: 4/15/19, 98-0.

Brief Summary of Substitute Bill

- For corporations formed on or after January 1, 2020, eliminates shareholders' preemptive rights to acquire unissued corporate shares and shareholders' cumulative voting rights in elections for directors, unless authorized in the articles of incorporation.
- Revises standards governing when shareholder approval is required for a sale or other disposition of the corporation's property and assets other than in the usual and regular course of business.

HOUSE COMMITTEE ON CIVIL RIGHTS & JUDICIARY

Majority Report: Do pass. Signed by 14 members: Representatives Jenkins, Chair; Thai, Vice Chair; Dufault, Assistant Ranking Minority Member; Goodman, Graham, Hansen, Kilduff, Kirby, Klippert, Orwall, Shea, Valdez, Walen and Ybarra.

Staff: Edie Adams (786-7180).

Background:

This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.

The Washington Business Corporations Act (WBCA) provides requirements for the creation, organization, and operation of corporations and the relationship between shareholders, directors, and officers of the corporation. Many of the provisions of the WBCA provide default rules that may be altered in the corporation's articles of incorporation or bylaws. The articles of incorporation and the bylaws are the governing documents for the corporation and set forth rules with respect to numerous organizational and operational issues.

The WBCA is modeled largely after the American Bar Association's revised Model Business Corporations Act (MBCA). The Corporate Act Revision Committee (CARC) of the Business Law Section of the Washington State Bar Association periodically reviews the WBCA and makes recommendations for updating the WBCA to keep it up to date with developments in the law and changes made to the MBCA and to corporate law in other states. The CARC recommends amendments to the WBCA to change default rules governing shareholders' preemptive rights and cumulative voting rights to be consistent with how these issues are addressed in the revised MBCA and the large majority of other states' corporate laws. In addition, the CARC recommends adopting an objective test for determining when a sale or other disposition of corporate property and assets requires shareholder approval, consistent with the approach used in the revised MBCA.

Preemptive Rights.

The WBCA provides a default rule that shareholders have a preemptive right to acquire proportional amounts of the corporation's unissued shares when the board of directors decides to issue them. A shareholder may waive the preemptive right, and preemptive rights are subject to a number of limitations. Shares subject to preemptive rights that are not acquired by shareholders may be issued to any person for a period of one year after being offered to shareholders and at a consideration that is not less than that offered for the exercise of preemptive rights. Any offer of shares after the one-year period or at a lower consideration is subject to the shareholder's preemptive rights.

Cumulative Voting.

A corporation is generally required to have a board of directors that exercises all corporate powers and manages the business and affairs of the corporation. Directors are elected by the shareholders of the corporation at the annual shareholders meeting. A corporation may have different classes or series of shares and authorize the election of all or a specified number of directors by the holders of one or more authorized classes or series of shares.

The WBCA establishes a default rule that shareholders authorized to vote in the election of directors may cumulate votes. Cumulative voting allows shareholders to multiply the number of votes they are entitled to cast by the number of directors for whom they are entitled to vote and to cast the product for a single candidate or distribute the product between two or more candidates.

Disposition of a Corporation's Property and Assets.

The WBCA provides rules regarding the sale, lease, exchange or other disposition of the corporation's property. A sale or other disposition of the corporation's property and assets in the usual and regular course of business does not require shareholder approval unless the articles of incorporation provide otherwise.

Shareholder approval is required for the sale or other disposition of all or substantially all of the corporation's property and assets otherwise than in the usual and regular course of business. There is no definition of what constitutes "all or substantially all" of the corporation's property and assets. The board of directors must submit the proposed disposition to the shareholders and, except under certain circumstances, recommend adoption of the proposed disposition to the shareholders.

The shareholders entitled to vote must approve the disposition by two-thirds of the voting group consisting of all the votes entitled to be cast, and of each other voting group entitled to vote separately on the proposal. In addition, the board of directors may condition its submission of the proposal on any basis, including the affirmative vote of holders of a specified percentage of shares held by any group of shareholders not otherwise entitled to vote as a separate voting group. The articles of incorporation may require a greater or lesser vote that is not less than a majority of votes entitled to be cast. After approval, a disposition of the corporation's property and assets may be abandoned without shareholder approval.

Summary of Bill:

The Washington Business Corporations Act (WBCA) is amended to address shareholders' preemptive rights to acquire unissued shares, shareholders' cumulative voting rights, and standards for when the disposition of corporate property and assets requires shareholder approval.

Preemptive Rights.

Shareholders of corporations formed on or after January 1, 2020, do not have a preemptive right to acquire the corporation's unissued shares unless the articles of incorporation provide otherwise. Preemptive rights may be established in the articles of incorporation with a statement that the corporation elects to have preemptive rights or words of similar import, and the articles of incorporation may establish alternative rules applicable to preemptive rights.

Shareholders of corporations formed before January 1, 2020, retain preemptive rights to acquire a corporation's unissued shares, unless otherwise provided in the articles of incorporation, subject to the limitations provided in the WBCA.

Cumulative Voting.

Shareholders of corporations formed on or after January 1, 2020, do not have the right to cumulate votes for the election of directors unless the articles of incorporation provide otherwise. Cumulative voting rights may be established in the articles of incorporation with a statement that all or a designated group of shareholders are entitled to cumulate their votes for directors, or words of similar import.

Shareholders of corporations formed before January 1, 2020, retain the right to cumulate their votes for directors unless the articles of incorporation provide otherwise.

A notice requirement is established in order to exercise the right to cumulate votes. Shares may not be voted cumulatively at a particular meeting unless: (a) the meeting notice or proxy statement accompanying the meeting notice clearly states that cumulative voting is

authorized; and (b) a shareholder who has the right to vote cumulatively provides 72-hours' notice to the corporation of the intent to cumulate votes during the meeting. The notice provided by one shareholder entitles all other shareholders in the same voting group to cumulate their votes without giving further notice.

Disposition of a Corporation's Property and Assets.

A sale, lease, exchange, or other disposition of the corporation's property and assets other than in the usual and regular course of its business requires shareholder approval if the disposition would leave the corporation without a significant continuing business activity.

A significant continuing business activity is conclusively presumed if, for the corporation and its subsidiaries, a continuing business activity represents at least: (a) 25 percent of total assets at the end of the most recently completed fiscal year; and (b) either 25 percent of income from continuing operations before taxes, or 25 percent of revenues from continuing operations, for the most recently completed fiscal year.

The fact that a continuing business activity does not equal or exceed these requirements does not create a presumption that the disposition will leave the corporation without a significant continuing business activity.

The assets of a subsidiary are to be treated as the assets of its parent corporation for the purposes of requirements relating to disposition of a corporation's property or assets.

Appropriation: None.

Fiscal Note: Not requested.

Effective Date: The bill takes effect 90 days after adjournment of the session in which the bill is passed.

Staff Summary of Public Testimony:

(In support) This bill is brought forward by the Corporate Act Revision Committee (CARC) of the Washington State Bar Association. The CARC is a group of dedicated attorneys who have worked for close to 30 years to make sure Washington remains one of the best places to organize a company. Currently, Washington corporation law has an opt-out policy for shareholders' preemptive rights and cumulative voting. It is standard practice when incorporating a company in Washington to reverse the default rule, and almost every other state has an opt-in approach. This creates a trap for out-of-state practitioners.

With respect to shareholder approval for disposition of corporate assets, virtually all states have the same rule as Washington: shareholder approval is required for any sale of "all or substantially all" of the company's assets. This is a subjective test that is difficult to apply. There is no consensus regarding what that phrase means, so there is a wide variation in practice, and it makes it more costly because corporations may be getting shareholder approval when it is not needed. The standard of "significant continuing business activity" has been adopted under the model act. It provides an objective test and a safe harbor on which corporations may rely.

(Opposed) None.

Persons Testifying: Senator Pedersen, prime sponsor; and Michael Hutchings, Corporate Act Revision Committee.

Persons Signed In To Testify But Not Testifying: None.