

SENATE BILL REPORT

SB 5003

As Reported by Senate Committee On:
Law & Justice, January 24, 2019

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

Brief Description: Concerning Washington's business corporation act.

Sponsors: Senators Pedersen and Padden; by request of Washington State Bar Association.

Brief History:

Committee Activity: Law & Justice: 1/17/19, 1/24/19 [DPS].

Brief Summary of First Substitute Bill

- Eliminates shareholders' preemptive rights to acquire unissued corporate shares, unless authorized in the articles of incorporation of those corporations formed on or after January 1, 2020.
- Eliminates shareholders' cumulative voting rights during director elections, unless authorized in the articles of incorporation of those corporations formed on or after January 1, 2020.
- Adds criteria for determining if a significant continuing business activity remains after disposition of corporate property and assets outside the regular course of business.

SENATE COMMITTEE ON LAW & JUSTICE

Majority Report: That Substitute Senate Bill No. 5003 be substituted therefor, and the substitute bill do pass.

Signed by Senators Pedersen, Chair; Dhingra, Vice Chair; Padden, Ranking Member; Holy, Kuderer, Salomon and Wilson, L..

Staff: Melissa Burke-Cain (786-7755)

Background: Shareholders' Preemptive Rights to Acquire Unissued Stock Shares. RCW 23B.06.300 provides preemptive rights for shareholders of a Washington corporation to acquire proportional amounts of the corporation's unissued shares when the board of

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directors decides to issue them. The corporation's articles of incorporation may provide otherwise, and shareholders may waive their preemptive rights. According to the Washington State Bar Association (WSBA) Corporate Act Revision Committee (CARC), Washington's law differs in this regard from the current Model Business Corporations Act (MBCA) and the business corporation laws in over 40 states.

Cumulative Voting by Shareholders During Director Elections. RCW 23B.07.280 currently entitles corporate shareholders to cumulate votes in director elections unless prohibited by the articles of incorporation. 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. The shareholders may then cast all the votes for a single candidate or distribute the votes among two or more candidates. According to the WSBA CARC, Washington's law in this regard differs from the current MBCA and the business corporations laws in over 30 states.

Shareholder Approval of Disposition of Corporate Assets Inside and Outside the Regular Course of Business. Under RCW 23B.12.010, a corporation's board of directors may dispose of all, or substantially all, of its property and assets in the regular course of business unless the articles of incorporation require shareholder approval. Under RCW 23B.12.020, shareholders must approve transactions involving the sale or other disposition of all, or substantially all, of a corporation's property and assets when the disposition is outside the regular course of business. The law does not define what constitutes disposition of all or substantially all of a corporation's property and assets. According to the WSBA CARC, the current law largely reflects the 1984 version of the MBCA.

The current version of the MBCA requires shareholder approval for disposition of property and assets outside the regular course of business if the disposition would leave the corporation without a significant continuing business activity. Chapter 12 of the revised MBCA contains criteria for determining whether a corporation retains a significant continuing business activity. According to the WSBA CARC, 13 states follow the revised MBCA's criteria although several states have adopted it with changes.

Summary of Bill: The bill as referred to committee not considered.

Summary of Bill (First Substitute): A shareholder of a corporation formed on or after January 1, 2020, does not have a preemptive right to acquire a corporation's unissued shares unless the articles of incorporation provide for preemptive rights. For earlier-formed corporations, a shareholder has preemptive rights, but may waive their rights to acquire unissued shares.

A shareholder of a corporation formed on or after January 1, 2020, is not entitled to cumulate votes in a director election unless the articles of incorporation provide for cumulative voting. For earlier-formed corporations, a shareholder is entitled to cumulate votes in a director election. For authorized cumulative voting to occur, the meeting notice must clearly state that cumulative voting at the meeting is authorized; or a shareholder with the right to cumulate votes must notify the corporation no less than 72-hours before the meeting that they intend to cumulate votes. If one shareholder gives this notice, the other shareholders in the voting group may cumulate their votes without giving further notice.

When a corporation sells or otherwise disposes of corporate property and assets outside the regular course of business, the shareholders must approve the disposition if the result would leave the corporation without a significant continuing business activity. A significant continuing business activity exists if the remaining activity represents:

- 25 percent of the total assets at the end of the most recently completed fiscal year; and
- either 25 percent of income from continuing operations for that fiscal year; or 25 percent of revenues from continuing operations for that fiscal year.

Appropriation: None.

Fiscal Note: Not requested.

Creates Committee/Commission/Task Force that includes Legislative members: No.

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

Staff Summary of Public Testimony on First Substitute: PRO: Currently Washington has an opt out state business corporations law with respect to shareholders' preemptive rights and cumulative voting. This makes Washington an outlier compared with other states that use an opt in approach. An opt in approach allows flexibility for a corporation to choose whether to allow preemptive rights or cumulative voting by making provision in their articles of incorporation. The opt out approach becomes a potential trap for an unwary attorney for a corporation whether from Washington or from another state who may not realize that Washington's business corporation law grants preemptive rights and cumulative voting rights to shareholders unless the articles of incorporation state otherwise. As to shareholder approval of disposition of corporate property and assets if the disposition leaves the corporation without a significant continuing business activity, most states have a similar law to Washington's in which a significant continuing business activity is not defined. Although good in theory, the lack of objective criteria is very difficult in practice because a corporation often has no easy way to determine whether shareholder approval is required. The significant continuing business activity is described differently in different states and these highly variable approaches leave the corporation without clear guidance. The Corporate Act Revision Committee (CARC) view is that the Model Act criteria provides a helpful process so a corporation knows whether a threshold is met or not for shareholder approval. By applying the criteria, the corporation can be confident it does not need shareholder approval to dispose of property outside the normal course of business.

Persons Testifying: PRO: Senator Jamie Pedersen, Prime Sponsor; Michael Hutchings, CARC.

Persons Signed In To Testify But Not Testifying: No one.