

SENATE JUDICIARY COMMITTEE
Senator Thomas Umberg, Chair
2021-2022 Regular Session

AB 1381 (Gallagher)
Version: May 19, 2022
Hearing Date: June 8, 2022
Fiscal: Yes
Urgency: No
AWM

SUBJECT

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

DIGEST

This bill requires the Secretary of State to notify a limited liability company (LLC) when an updated statement of information for that LLC has been delivered for filing.

EXECUTIVE SUMMARY

The California Revised Uniform Limited Liability Company Act (the Act) governs all LLCs formed in California. The Act provides requirements for how an LLC may be formed and what information the LLC must provide to the Secretary of State, such as the addresses of the LLC's principal place of business and its agent for service of process, the contact information for its manager or managing members, and the type of business the LLC is engaged in. Generally, this information must be provided once every two years in a statement of information filed with the Secretary of State; however, if the LLC changes its agent for service of process or the agent changes their address, the LLC must file a statement of information with the new information at that point. Additionally, an LLC may file a statement of information to update other required information before the two-year deadline. Information in a statement of information filed with the Secretary of State supersedes all previous information on that point.

According to the author and sponsor of the bill, the relative ease of filing a statement of information leaves open the potential for fraud. Specifically, they state that persons are currently able to file a fraudulent statement of information that, e.g., lists themselves as a manager of the LLC, and when that information is updated on the Secretary of State's website, use the website as proof of membership and borrow against the LLC's assets. Because an LLC does not receive notice when a statement of information is filed on its behalf, an LLC could go months or years before it realizes that a third party filed a fraudulent statement of information, long after the fraud was accomplished.

In order to mitigate the risk of fraudulently filed statements of information, this bill requires the Secretary of State to send a notice to the LLC's last-recorded address or email address when it receives a statement of information (i.e., the address or email address the Secretary of State had on file prior to the filing of the newly received statement of information). This is intended to give the LLC notice of the filing so that the LLC can take swift action if it believes the statement was fraudulently filed. The author has agreed to amendments to address some of the concerns raised by the Secretary of State.

This bill is sponsored by the California Land Title Association. The bill is opposed by the Secretary of State.

PROPOSED CHANGES TO THE LAW

Existing law:

- 1) Establishes the California Revised Uniform Limited Liability Company Act, which governs the formation and regulation of limited liability companies in this state. (Corp. Code, tit. 2.6, §§ 17701.01 et seq.)
- 2) Defines the following relevant terms:
 - a) A "foreign limited liability company" is an unincorporated entity formed under the law of a jurisdiction other than this state and denominated by that law as a limited liability company. (Corp. Code, § 17701.02(j).)
 - b) A "limited liability company," except in the phrase "foreign limited liability company," is a domestic entity formed under the Act. (Corp. Code, § 17701.02(k).)
- 3) Requires every limited liability company and every foreign limited liability company registered to transact intrastate business in this state to deliver to the SOS a statement of information that contains the following information:
 - a) The name of the LLC, the filing number issued by the Secretary of State, and for a foreign LLC, the name under which it is authorized to transact business in this state and the jurisdiction under the laws of which it was organized.
 - b) The name and address of its agent in this state for service of process.
 - c) The street address of its principal office.
 - d) The mailing address of the LLC, if different from its principal office.
 - e) The name and complete business or residence address of any manager(s) and the chief executive officer, if any; or, if no manager or officer has been elected, the name and business or residence address of each member.
 - f) The valid email address for the LLC, if the LLC chooses to receive renewal notices and other notifications from the Secretary of State by email.
 - g) The general type of business that constitutes the LLC's principal business activity.

- h) A statement indicating whether any member or manager has an outstanding final judgment issued by the Division of Labor Standards Enforcement or a court of law, for which no appeal therefrom is pending, for the violation of a wage order or provision of the Labor Code. (Corp. Code, § 17702.09(a).)
- 4) Provides that a statement of information must be filed at the following times:
 - a) Ninety days after the LLC files its original articles of organization or, for a foreign LLC, its registration to transact intrastate business in the state;
 - b) Biennially after the first statement.
 - c) When the LLC changes its agent for service of process or the address of the agent.
 - d) At the discretion of the LLC, when the LLC changes information required to be disclosed under 3) other than the information relating to the agent for service of process; the LLC may also opt to wait until its regular filing period. (Corp. Code, § 17702.09(a), (d).)
 - 5) Requires the Secretary of State to provide a notice to each LLC or foreign LLC to comply with the filing requirement approximately three months prior to the closing of the filing period, to the last mailing address or email address according to the records of the Secretary of State. (Corp. Code, § 17702.09(c).)
 - 6) Provides that information in the most recently filed statement of information supersedes the information in any previously filed statement of information, statement in the articles of organization, or, for a foreign LLC, statement in the application for registration. (Corp. Code, § 17702.09(d).)

This bill:

- 1) Requires, by January 1, 2024, the Secretary of State to create and implement a procedure to transmit a notice to an LLC or foreign LLC stating that an updated statement of information has been delivered for filing for the LLC.
- 2) Provides that the Secretary of State must transmit the notice to the mailing address or email address of the LLC that was previously on file before the submission of the updated statement of information.
- 3) Provides that the Secretary of State may send the notice either before or after the updated statement of information is filed.
- 4) Makes certain nonsubstantive and technical changes.

COMMENTS

1. Author's comment

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. This bill requires the Secretary of State to notify an LLC when it receives an updated statement of information from that LLC

A statement information is the means by which an LLC formed or doing business in California updates the Secretary of State when specific key information changes, such as the names of its members or managers, its place of business, or its agent for service of process in the state.¹ An LLC must file a statement of information every two years as a matter of course; if the required information has not changed since the prior filing, the LLC may state that no changes have occurred in the applicable filing period.² Additionally, the LLC must file an updated statement of information when its agent for service of process, or its agent's address, changes, and may file an updated statement when any of the other information changes.³ The information in a statement of information supersedes all prior information filed on that point, including statements in a prior statement of information, the LLC's filed articles of incorporation, or a foreign LLC's application for registration.⁴

According to the author and sponsor of the bill, the statement of information filing system lacks protections against fraudulent updates. Under current law, a person could file a false statement of information that, e.g., names themselves as the manager; the Secretary of State would then update the LLC's records accordingly, and the person could fraudulently borrow against the LLC's assets on the basis of their falsified ownership in the company. In such cases, the actual members or managers of the LLC might not discover the fraud for months or even years, because they would have no reason to know that the false statement was filed. A white paper issued by the National Association of Secretaries of State (NASS) discusses this type of business identity fraud

¹ Corp. Code, § 17702.09(a).

² *Id.*, § 17702.09(a), (b).

³ *Id.*, § 17702.09(a), (d).

⁴ *Id.*, § 17702.09(d).

as one of a number of business identity theft issues facing secretaries of state across the country.⁵

This bill would adopt one of the NASS's recommended "best practices" to avoid business identity fraud by requiring the Secretary of state to notify an LLC whenever it receives a statement of information to be filed on behalf of that LLC. This provision is intended to give LLCs reasonably timely notice of any new statement of information so that, if the statement has been fraudulently filed, the LLC can quickly address it and prevent any fraudulent compromising of its assets. The bill further specifies that the notice must be sent to the physical or email address the LLC had on file prior to the submission of the new statement of information, to ensure that, if the new statement of information fraudulently changes the LLC's address, the LLC still receives notice.⁶

The Secretary of State recently submitted an opposition letter to this Committee setting forth three primary concerns with the bill. First, the Secretary of State argues that, in light of the launch of the SOS bizfile Online website, which allows LLCs and other businesses to submit filings online, there is no longer a risk of the business fraud addressed by this bill. Second, the Secretary of State is concerned that the bill's reference to sending the notice when a statement of information "has been delivered for filing" would require the Secretary of State's office to unnecessarily delay filings upon receipt. Finally, the Secretary of State is concerned that the "delivered for filing" and the provision allowing the notice to be sent before or after filing could be interpreted to give the Secretary of State an obligation to determine whether a statement of information is appropriate for filing, rather than filing statements of information as a ministerial act.

With regard to the first argument – that the availability of online filing moots the need for notice – it should be noted that online filing is available, but not mandatory. An LLC may opt to file online or through a paper form sent through the physical mail. Moreover, according to the Secretary of State's office, the online portal does not currently provide any email notice to an LLC when a new statement of information or other document is filed, so the only way an LLC would know if a fraudulent statement of information had been filed would be if it happened to check their online account and saw an unauthorized filing.

Regarding the second and third issues – relating to the timing of the notice and the concern that the Secretary of State will inadvertently be charged with judging between competing statements of information – the author has agreed to take amendments to

⁵ National Association of Secretaries of State, *Developing State Solutions to Business Identity Theft: Assistance, Prevention, and Detection Efforts by Secretary of State Offices* (Jan. 2012) at p. 6.

⁶ If an LLC nonfraudulently updates its physical or email address, there is a chance it will not receive the notice if, e.g., it has not set up a mail forwarding system. In this case, however, the interest in notifying the LLC would be greatly reduced because the LLC did, in fact, update its address, and there is no fraud to protect against.

address these concerns, set forth below. The bill is not intended to require the Secretary of State to take any additional steps other than send a notice to an LLC after a statement of information is filed on its behalf; it is the intent of the author that the bill would not change the Secretary of State's existing practices for when it is informed of a dispute over the control of an LLC.

The author has agreed to continue to work with the Secretary of State's office to try and resolve the office's remaining concerns.

3. Amendments

The author has agreed to amend the bill to address certain of the Secretary of State's concerns relating to the timing of the notice and the potential for an unintended imposition of an obligation on the Secretary of State to verify statements of information before filing them. To wit, these amendments make clear that the notice of a filing should be sent out after the statement of information is filed – so as not to disturb any automated filing systems the Secretary of State has in place – and remove the last sentence so as to make clear that the Secretary of State is not required to engage in any pre-filing review before filing the statement of information. The precise amendments are as follows, subject to any nonsubstantive changes made by the Office of Legislative Counsel:

Amendment 1

On page 5, in line 4, strike out “delivered for filing” and insert “filed”

Amendment 2

On page 5, in line 10, strike out “The Secretary of State may send the” and strike out lines 11-12, inclusive.

4. Arguments in support

According to the sponsor of the bill, the California Land Title Association:

Unfortunately, once an LLC's [statement of information (SI)] is filed, a person seeking to commit fraud can easily overwrite a genuine SI by uploading a document containing false information to the Secretary of State database. Often the person committing the fraud will change the names of the principals of the LLC, or their contact information, etc., so that they can essentially steal the identity of the LLC. Such actions are possible because:

- The database is not secure and does NOT require the filer to create a username or password.

- Subsequent modifications to the LLCs, even if fraudulent, do NOT trigger a notification to the original party filing the SI that a change has been made. Unless the filer constantly monitors his or her filings, they will be none the wiser.
- Many business owners who file the LLC SIs probably assume these filings are secure and protected. Therefore, we find it highly unlikely that the responsible parties within LLCs are constantly checking their LLC filings for subsequent tampering.

Once the fraudsters have successfully modified the SIs of an LLC without the business owners realizing it, they are free to generate loans, conduct fraudulent transactions, etc., using the “hijacked” LLC identity they have recently acquired. Innocent parties involved in transactions with the hijacked LLC would not be aware they have been duped even if they conduct due diligence by verifying the supposed authenticity of the LLC on the Secretary of State website...

In a 2012 white paper entitled *Developing State Solutions to Business Identity Theft*, the NASS—a national association comprised of Secretaries of State from across the country, including California—provided five recommendations for states to consider in grappling with the problem of business identity theft. Among them was a recommendation that states establish a notification process for businesses, as proposed by AB 1381, which would be “an effective method for reducing instances of business identity theft and assisting potential victims of this crime.”⁷

5. Arguments in opposition

According to the Secretary of State, writing in opposition:

Although AB 1381 contains a delayed operative date of January 1, 2024, there is no workable implementation date for this bill as drafted. The SOS bizfile Online system, which recently went live following Module 4 of the California Business Connect Project, already ensures that business customers have unique logins that prevent mistaken or illegal filings to be submitted for their entity. This protection greatly exceeds the security provided in AB 1381. This bill would require SOS to pursue a substantial new change order for bizfile Online, and unlike bizfile Online, would not actively prevent any inappropriate filings and could inadvertently create system instability.

This measure would also create processing delays and cause customer confusion with SOS filing processes based on the “delivered for filing” provision. It is not our agency practice to create unnecessary delays for businesses eager to take part

⁷ National Association of Secretaries of State, *Developing State Solutions to Business Identity Theft: Assistance, Prevention, and Detection Efforts by Secretary of State Offices* (Jan. 2012) at p. 17.

in economic activity. Many businesses need accelerated processing of their filings for business-related reasons. Implementing this amended proposal would require custom coding to significantly alter SOS filing systems and would come at a cost.

In addition, this proposal would place SOS in the position of potentially having to adjudicate disputes between multiple parties that may claim authority over an entity to file on its behalf. As a filing agency, this has never been a duty of SOS. AB 1381 would remove vital uniformity and consistency across multiple entity types. This is especially problematic for businesses such as law firms and service companies that draft and submit filing forms on behalf of business entities.

SUPPORT

California Land Title Association (sponsor)

OPPOSITION

Secretary of State Shirley N. Weber

RELATED LEGISLATION

Pending legislation: AB 2431 (Assembly Banking and Finance Committee, 2022) clarifies the information an LLC must include in its statement of information relating to outstanding judgments to specify that: in a manager-managed LLC, the statement must indicate whether any manager has an outstanding final judgment related to a wage order or Labor Code violations; and that in a member-managed LLC, the statement must indicate whether any managing member has such an outstanding final judgment. AB 2431 is pending before the Senate Judiciary Committee and is scheduled to be heard on the same date as this bill.

Prior legislation:

AB 3075 (Gonzalez, Ch. 357, Stats. 2020) required, beginning January 1, 2022, that LLCs and other business entities disclose whether key members have any outstanding final judgments issued by the Division of Labor Standards Enforcement or a court of law, for which no appeal therefrom is pending, for the violation of any wage order or provision of the Labor Code.

AB 786 (Kiley, 2017) would have required, among other documents, the statement of information to be permitted to be filed with the Secretary of State through online means. AB 786 died in the Assembly Banking and Finance Committee.

PRIOR VOTES:

Assembly Floor (Ayes 61, Noes 0)

Assembly Appropriations Committee (Ayes 15, Noes 0)

Assembly Banking and Finance Committee (Ayes 11, Noes 0)
