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MEMORANDUM

TO: Secretary of State's Working Group

FROM: Herrick K. Lidstone, Jr., member, working group

DATE: September 7, 2022

SUBJECT: Comments for Upcoming Meeting

1. **Legislative Background.** The legislative background for the working group is based on S.B. 22-034 which added § 7-90-315 to the Colorado Corporations and Associations Act.

From Colorado Revised Statutes § 7-90-315(1): “The working group to study measures to counteract fraudulent filings in the online business filing system, referred to in this section as the ‘working group,’ is hereby created to study potential measures to counteract and prevent fraudulent filings in the online business filing system.”

From Colorado Revised Statutes § 7-90-315(3): “The working group shall submit a report to the general assembly by January 31, 2023, containing potential legislative provisions to counteract and prevent fraudulent filings, as well as the costs and benefits associated with each potential legislative provision. The report may include specific recommendations to the general assembly.”

2. **General Statement.**

Colorado Statutes and the procedures established over a significant period of time have made Colorado a very business-friendly state. Documents can be filed day or night and generally become effective when filed. Little information need be set forth in the articles of incorporation,¹ articles of organization,² certificates of limited partnership (§ 7-62-201),³ a registration statement for a limited partnership or a general partnership,⁴ or articles of association for a limited partnership association (§ 7-63-105).

“Filing” of documents with the Secretary of State is defined at length in the Colorado Corporations and Associations Act (the “CCAA”) at § 7-90-301 *et seq.* Of importance to this

¹ Articles of incorporation are filed to form a corporation (§ 7-102-101) or a nonprofit corporation (§ 7-122-101).

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working group is § 7-90-306(1) which states that, if a document presented to the Secretary of State for filing complies with the requirements of § 7-90-301, the Secretary of State **shall** make the filing. Section 7-90-306(1) goes on to say that “The Secretary of State has no duty to determine whether the document complies with any or all requirements of any law.”

Section 7-90-301 sets forth the requirements for filing a document, and includes § 301(1)(b): “To be entitled to be filed pursuant to this part 3, a document shall be subject to this part 3 and shall comply with the requirements of this section and the requirements of any other law of this state that adds to or varies the requirements of this part 3.”

3. Convenience versus Security – For Existing Organizations Hijacked by Others.

A comment was made that the Secretary of State’s filing system is not secure because any person can make a filing to affect an organization’s record. That was followed by the statement that the owner of the organization (the “hijacked organization”) has no recourse.

This is not correct in a number of ways, all of which are within the control of those who control the organization.

- a. The Secretary of State provides extremely prompt notification to any person who has subscribed to notifications for an organization. This person may be the person in control of the organization, legal counsel, accountants, or others whether or not they have any connection to the organization. Notifications will be sent via text or email, as designated by the subscriber, for any filing that an organization may make – whether it be a periodic report, amendments to articles, change of registered agent, or otherwise.
- b. When an organization has had a document filed improperly against it (a “hijacked organization”), effective on February 1, 2023 (the effective date of C.R.S. § 7-90-314 enacted in S.B. 22-034), the Secretary of State, in conjunction

² Articles of organization are filed to form a limited liability company (§ 7-80-203), an Article 55 cooperative association (§ 7-55-102), an Article 56 cooperative (§ 7-56-201), or an Article 58 limited cooperative association (§ 7-58-302).

³ Only a limited partnership formed under CULPA requires a filing with the Secretary of State. Under CULPL, a limited partnership was formed by a filing with the County Clerk and Recorder (§ 7-61-103), but limited partnerships subject to CULPL have not been formed since November 1, 1981 (§ 7-61-129.5).

⁴ A registration statement results in a general partnership being considered a “limited liability partnership” (“LLP”) and a limited partnership being a “limited liability limited partnership” (“LLLPL”). See §§ 7-60-144, 7-62-1104, and 7-64-1102).

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with the Attorney General's office, can provide recourse to the person notifying the Secretary of State of the issues.

- c. Persons can actually prevent filings against their organization by using a password to prevent unauthorized access to file business records necessary to hijack an organization. This is an individual choice by the persons in control of the organization.

Admittedly, persons who elect none of the protective measures do risk having their business organizations hijacked, notwithstanding their ability to be informed when an unauthorized filing occurs (allowing them to promptly protect their interests) and notwithstanding their ability to prevent an unauthorized filing by password-protecting the organization's records in the office of the Secretary of State.

I believe that no further actions should be taken at this time pending reviewing the success of the complaint, review, and appeal procedures when they become effective.

4. **Convenience versus Security – For New Organizations.**

Another issue raised is the complaint that a significant problem exists regarding newly-formed business organizations – formed by persons who need it for a fraudulent purpose. In some cases,

- a. These persons use names that are deceptively similar to existing business organizations, or
- b. Use addresses of other people not associated with the people forming the newly-formed organization, which results in inconvenience and occasionally financial loss to the persons whose addresses were hijacked.

These issues arise because of the ease of filing new organizations with the Secretary of State's office and the lack of that office's scrutiny of these filings.

The problem is apparently exacerbated by the fact that the Secretary of State's website will immediately issue a certificate of good standing and a record of the filed document, with the comment having been made that it is then too late for the Secretary of State to remedy the situation.

With respect to problem 4(a) [These persons use names that are deceptively similar to existing business organizations]; § 7-90-601(2) provides that:

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Except as provided in section 7-90-604 (4.5),⁵ each entity name shall be distinguishable on the records of the Secretary of State from every:

- (a) Other entity name; and
- (b) Name that is reserved with the Secretary of State for another person as an entity name pursuant to section 7-90-602.

The term “distinguishable on the records” is a very low standard to meet. As stated in the Secretary of State’s website, “Your business name must be distinguishable (unique) from every other name on record with the Secretary of State. When you register, the system will check if the name you want to use is unique. You can also see if anyone is using a similar name by searching the business database.” The Secretary of State’s website goes on to describe “what makes a name unique”⁶:

The following will make a name unique:

- Articles of speech such as ‘the’ and ‘a’
- Terms and abbreviations included in an entity name can make a name distinguishable. For example, a Limited Liability Company (“LLC”) must include the appropriate term or abbreviation in their name; however, entities with similar names could use different abbreviations for an LLC and be considered distinguishable. [These name rules apply to corporations, nonprofits, partnerships, and other entities filed with the secretary of state.]

The following pairs of names **are** distinguishable:

ABC LLC is not the same as ABC Limited Liability Company
ABC LLC is not the same as A B C LLC
ABC LLC is not the same as A-B-C LLC

⁵ This section provides that “A foreign entity that has in effect a registration of its true name may deliver to the Secretary of State, for filing pursuant to part 3 of this article, a statement of foreign entity authority stating that name as its true name.”

⁶https://www.sos.state.co.us/pubs/info_center/eLearningCourses/StartingABusinessInColoradoEnglish/page36790.html.

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ABC LLC is not the same as (ABC) LLC
ABC LLC is not the same as ABC INC

The following will not make a name distinguishable:

- Periods (.), commas (,), underscores (_), apostrophes (‘) and inverted apostrophes (’)
- Uppercase and lowercase letters are not distinguishable from each other

For example, the following pairs of names **are not** distinguishable:

ABC Inc is the same as abc inc
ABC Inc is the same as A.B.C. Inc
ABC Inc is the same as ABC, Inc.

One can, and should, argue whether these names that the Secretary of State believes “are distinguishable” are in fact sufficiently distinguishable.

The paragraph 4(b) problem [“Use addresses of other people not associated with the people forming the newly-formed organization, which results in inconvenience and occasionally financial loss to the persons whose addresses were hijacked”] is much more difficult to manage and again brings out the “convenience versus security” issues.

Can or should the Secretary of State check all addresses and names included on the filed documents before accepting the documents for filing?

Can or should the Secretary of State impose greater information disclosure requirements (such as contemplated in the Corporate Transparency Act) on filings she accepts?

Can the Secretary of State’s databases be made more accessible and searchable, and can the different databases be combined into a single one?

Can or should the Secretary of State delay filings until she reviews the filings in greater detail – meaning there would likely be a significantly greater lead time required for filings to be effective, and likely a much larger staff to do so, assisted by electronic devices?

Should the default in the Secretary of State’s records be to a secure (password protected) file rather than making that an election that can be made at the time of filing the articles (or thereafter)?

Should the Secretary of State impose some sort of additional disclosure from any filing party, whether information such as contemplated by the Corporate Transparency Act or such as requested by financial institutions in their “Know Your Customer” rules?

5. Corporate Transparency Act.

Much can be said about the federal Corporate Transparency Act which was scheduled to become effective January 1, 2022, but which is still in the rule-making stage, with only one of three sets of rules proposed and commented upon, and no further feedback having been received from FinCEN. To a large extent, implementation of the Corporate Transparency Act would resolve many of the issues before the working group – and will resolve them on a national basis – not just in Colorado.

With the stated goal of countering money laundering, the financing of terrorism, and other illicit activity, Congress enacted the CTA on January 1, 2021, as part of the National Defense Authorization Act. Under the CTA, most domestic businesses and foreign businesses registered to do business in the U.S. will now be required to disclose personal identifying information about their beneficial owners, senior officers, and other control persons to the U.S. Department of Treasury’s Financial Crimes Enforcement Network (“FinCEN”).

The CTA will require small legal entities, both domestic and foreign, to file information about themselves and the individuals who formed, own and control them with a division of the U.S. Treasury Department. Publicly reporting companies are exempt from CTA regulation because they file the same information required under the CTA with the Securities and Exchange Commission. When required, these filings will be made at the time of organization of the entity (or, if formation occurred before the effective date of the rules, up to two years later) and in all cases must be updated promptly should beneficial ownership or control information change.

6. Recommendations

My principal recommendation is that the Secretary of State better publicize the protective measures that they already have in place, including the email and text messaging about filings affecting businesses in which they are interested, and password protecting the ability to file documents against organizations that they control.

I think that the working group should discuss whether the password protection plan for filings should be the default that customers can opt out of, or whether it should continue to be a program that customers of the secretary of state’s office can opt into. I believe it should continue to be an “opt-in,” but I believe that the discussion should be had.

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I also believe that the secretary of state should better publicize the issues that we have been and will be discussing as being problematic with the existing filing system – including the hijacking of existing organizations and the possibility of similar (although not in the terms of § 7-90-601 “deceptively similar”) names that can be used.

I also believe that the secretary of state should change her guidance for what names are “deceptively similar” with the understanding that I believe it should be broader. Exactly how it should be changed should be discussed. That is regulatory, not statutory.

I believe that the secretary of state should publicize the upcoming procedures under S.B. 22-034 (that is, § 7-90-314) that will be established by rulemaking to be effective by February 1, 2013. I have not seen any proposed rulemaking on that topic yet.

I am open to discuss other suggestions by others, but I believe that it remains important for Colorado to maintain its filing system as it is, without significant delays.