

Corporate “Housekeeping”

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Originally Published: 10/1/1997, Balls and Burlaps

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A corporation is a unique legal creature. It exists only as a result of the state's acknowledgment that a fictitious entity with legal standing as a person exists. In order to maintain this legal fiction, certain "corporate formalities" must be met. If you fail to satisfy the minimal formalities, your corporate existence may be threatened in the event of a lawsuit.

The minimum corporate formalities usually include the following:

- (a) Maintaining permanent records of minutes of meetings of shareholders and directors;
- (b) Maintaining appropriate accounting records;
- (c) Maintaining a record of the shareholders, including the number of shares and the class of shares held by each;
- (d) Maintaining at the principal office of the corporation and available for the inspection of the shareholders, the following:
 - Articles of incorporation and all amendments;
 - Bylaws and all amendments;
 - Minutes of all shareholders' meetings, and all actions of the shareholders taken without a meeting;
 - Financial statements of the corporation, including the balance sheet and income statement for the current fiscal year;
 - Copies of all written communications to shareholders;
 - A list of the names and business addresses of all of the corporation's directors and officers; and
 - The corporation's most recent annual report delivered to the Secretary of State.

A corporation can help to protect your personal assets in the event of creditor suits. However, your personal assets are only protected to the extent that you treat the corporation wholly separate from yourself. The corporation must at all times be treated as a unique and self contained entity.

The most common mistake made which will allow a creditor or other injured party to get past the corporate shield and attach your personal assets is where an officer or director fails to keep corporate accounts separate from personal accounts. Commingling personal and business funds can allow another party to bypass the corporate entity and get to personal assets. If you treat the corporate entity as an alter ego of yourself, the "corporate veil" can be pierced. The suing party will try to attach your personal assets in the event their claim exceeds the corporate accounts and assets.

The following are some general corporate guidelines that will help you maintain your corporate protection.

1. INTERESTED PARTY LOANS Document all flows of cash and assets between corporate officers, director or shareholders and the corporation. If a loan is made from an interested party to the corporation or vice versa, be sure to include a legal interest rate, a time certain for repayment of the loan, provisions for extensions and penalties for late payment and choice of remedy provisions. If a court determines that a loan between the parties does not satisfy the traditional loan requirements, It may be viewed as a "sweetheart loan." The party owed money may then lose his, her or its secured position upon liquidation, and other creditors could get past the corporate shield.

2. ACTING AS CORPORATE AGENT When any officer is negotiating a contract or other document on behalf of the corporation, it is important to make sure that all negotiations are being conducted on behalf of the corporation. This is generally reflected on the document where the parties are listed and where the officer signs. Signing only the officer's name does not disclose to anyone, including a court, that the officer is acting as an agent on behalf of the corporation. Signing in the following manner is evidence that whatever has been promised in the document is a corporate and not a personal obligation:

[name of corporation]

BY: [print name]

Its: President

3. ADEQUATE CORPORATE DOCUMENTATION The best means of avoiding personal liability as an interested party in the corporation is to at all times maintain a clear, cohesive and legitimate paper trail. Everything the corporation does should be documented. Keeping a daily log may be the best manner of developing the paper trail, as well as documenting loans, disbursements, contributions, expenses and other normal accounting requirements.

4. MAINTAINING GOVERNMENT REQUIREMENTS A corporation is required to submit an annual report to the State. The annual report is used for tax purposes and to keep a record of the corporate shareholders. Maintaining all necessary business licenses is a safety measure which bolsters the treatment of the corporation as a separate legal entity.

5. MAINTAINING MINUTES It is important that annual and special minutes be maintained for both board of directors and shareholders meetings. Most decisions of the corporation can be and are made at the directors level, but shareholders must be kept abreast of the manner in which the corporation is proceeding. Also, any "extraordinary" corporate acts must be approved through special minutes of the shareholders. For instance, most mergers and acquisitions should be approved by a vote of the shareholders, as well as a decision to dissolve and liquidate the corporation. Anything that falls outside of the usual and ordinary course of business is probably in the category of an extraordinary corporate act.

As an alternative to minutes, you can use a document referred to as a "Consent in Lieu of Meeting," which is in effect an agreement to forego a special or annual meeting in exchange for express approval by all of the shareholders or directors of whatever corporate act is being contemplated.

6. FIDUCIARY OBLIGATIONS To avoid suits based on "breach of fiduciary obligations," certain fiduciary duties owed by majority or controlling shareholders, officers, and directors in a corporation should be followed:

- (a) The duties of utmost good faith, fair dealing and full disclosure;
- (b) No self-dealing. In other words, one cannot: usurp corporate opportunities; place one's personal profit motives above the corporation's; convert private corporate information for one's own interest; or bypass what are clearly corporate opportunities for some self-serving motive;
- (c) No secret profits to the corporation's detriment;
- (d) Exercising one's best business judgment when making decisions for the corporation;
- (e) Avoid any dealings involving fraud misrepresentation or failure to State a material fact with intent to defraud other shareholders.

7. PIERCING THE CORPORATE VEIL The best rule to apply to corporate management to avoid piercing of the corporate veil is to conscientiously keep the affairs of the corporation separate from personal affairs, and to avoid perpetrating fraud or injustice upon third persons dealing with the corporation.

Courts are reticent to pierce the corporate veil. The belief that shareholders should be liable to third parties only to the extent of their investment in the corporation is cemented in the law. Problems arise when an officer in a closely held corporation operates the business not as a corporation, but more like a sole proprietorship.

8. INADEQUATE CAPITALIZATION Another instance where the corporate veil may be pierced is where a corporation is organized and carries on business without having substantial capital to meet its debts. The courts rationalize that shareholders should not be allowed to set up a flimsy organization to escape personal liability. The attempt to do corporate business without providing sufficient capital to meet the corporations financial responsibilities to creditors can be

an abuse of the separate corporate entity and may be ineffectual to protect the shareholders from corporate debts.

Establishing a corporation with flimsy or illusory capital can be deemed to be a fraud perpetuated on creditors. A good rule of thumb is to provide sufficient unencumbered capital to meet the corporation's reasonably foreseeable business risks and liabilities.

9. UNNECESSARY DEPLETION OF ASSETS On a final note, remember that siphoning funds or assets unnecessarily from the corporation through such things as excessively high salaries, bonuses, or other payments to insiders may also lead to piercing the corporate veil.

Good luck!

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