



Weekly Information Sheet 07

# CORPORATE FORMATION

## Defined

### "Corporation" Defined

Black's Law Dictionary defines a "Corporation" as

*"An artificial person or legal entity created by or under the authority of the laws of the state or nation, which has an existence distinct from that of its associated individuals, and has a duration that is either perpetual or for a limited term of years, and which acts as a unit in matters relating to the common purpose of the association and within the scope of the powers conferred upon it by law."*

## Meaning

### Legal Entity of to Itself: An Artificial Person Under the Law

A corporation is a legal entity (an artificial person) created in accordance with statutes.

The corporate entity is separate and distinct from the legal personalities of those who own and manage the corporation.

In New York, as elsewhere, corporate law is mostly statutory, and most of the statutory law relating to general business corporations (*i.e.*, corporations for profit) is contained in the New York Business Corporation Law ("BCL").

## Principal Characteristics

In general, corporations have the following characteristics:

- **Limited Liability**
- **Entity Powers (Corporate Personhood)**
- **Centralized Management**
- **Continuity of Existence**
- **Free Transferability of Interests**
- **Statutory Sources of Authority**
- **Constitutional Status**

# Corporation Attributes and Activities

## • Business Corporations

Under New York Law [Section 201 of the Business Corporation Law], a Business Corporation is:

- A private corporation under the law;
- A corporation that is established to conduct a business for profit; and
- Limited in the liability of its shareholders.

## • Pre-incorporation Activities

Pre-incorporation activities of promoters, such as those activities necessary to establish the corporation, or the business in which it will engage, can be ratified by the adoption of such by the board of directors, after the corporation is established.

## • Formation of Corporations

Pursuant to a general incorporation acts (such as the provisions of the Business Corporation Law) incorporation of a new corporate entity can be accomplished by:

- **Having incorporators (natural people over 18) prepare a certificate of incorporation which conforms to all state laws;**
- **Filing the certificate of incorporation with the office of the secretary of state; and**
- **Paying all necessary state incorporation fees**

## • Corporate Ownership

An ownership interest in a corporation is represented by shares of stock in the Corporation. Voting shares allow the shareholder to elect members of the board of directors of the corporation and control certain decisions of corporation policy.

## • Limitation of Investment

Financial Investments in a corporation are made by purchasing shares of stock in the corporation.

The monies used to purchase the shares of stock, inherently limit the exposure of the investor, and the shares so purchased give investors certain rights with respect to the corporation

# Corporate Formation

## • In General

A corporation is formed by compliance with the formalities prescribed in the New York State Business Corporation Law (BCL).

The creation of corporations by special act of the legislature is prohibited except for municipal purposes or for cases where, in the judgment of the legislature, the corporation's objectives cannot be attained under the general laws. [See N.Y. Const., art. 10, §1].

## • Rules for Corporate Formations

The rules that govern a corporation come from the following sources:

- **States Constitutions**
- **State Statutes**
- **Articles of Incorporation**

# Corporate Formation

## • STEPS AND ENTITIES INVOLVED IN CORPORATE FORMATION:

### Preliminary Incorporation Activities

- Preincorporation
- Promoters
- Subscriptions

### Legal Process of Incorporation

- Incorporators
- Articles (Certificates) of Incorporation
- Office of the Secretary of State
- Filing

### Post Incorporation Requirements

- Organizational Meeting
- Issuance of Shares
- Election of Board of Directors
- Appointment of Corporate Officers
- Adoption of Corporate Bylaws

## • Promoters

**Definition:** As used by the courts, the term "promoter" has been defined as:

***"A fiduciary who provides the organizational initiative for the founding of a business enterprise, and who sets in motion all that needs to be done to form the corporation that will conduct the business enterprise"***

It is not defined in the business corporation law, and is not a term of art, but rather a term of Business.

**Role of Promoters:** *The role of a promoter includes:*

- ***Working on a plan to build, organize and bring about a new business enterprise;***
- ***Bringing together persons interested in the new enterprise;***
- ***Preparing the prospectus, advertising and documentation promoting the new company;***
- ***Aiding in the procurement of subscriptions for shares in the future corporation; and***
- ***Ending their role and liabilities upon the functioning of the new corporation.***

**Generally:** Promoters are persons who provide the organizational initiative for the founding of a business and for the formation of a corporation (or other form) to carry on the business.

**What They Do:** Promoters sell subscriptions for the purchase of stock in the proposed corporation, court prospective investors, and perform other organizational details that the corporation needs in its pre-incorporation existence.

**They Have a Fiduciary Duty:** Promoters have certain fiduciary duties aimed at protecting (indirectly) the "outsiders" who invest. Promoters may be, but need not be, the "incorporators."

# Corporate Formation Continued

## • Promoters Continued

**Duties of Promoters:** The duties of a promoter flow from their position as fiduciary. Accordingly, they have wide powers to organize the formation of a corporation. Although they are not an agent (since the corporation has yet to come into existence) their legal relationship as a fiduciary with the proposed corporation they promote, and as to those persons whom they induce to become shareholders, is pronounced and serious.

**Liability of Promoters:** Promoters are personally liable for contracts made on behalf of the corporation before its existence. The corporation is not liable on these contracts unless and until it adopts them through ratification after it comes into existence. They are also liable for any untrue statements on a prospectus, for fraud in promoting the corporation, for misapplication or wrongful retention of corporate property, for misfeasance or breach of trust in representing the corporation to third parties.

## • Subscriptions

One of the most important roles of a promoter is the sale of stock subscriptions.

**Defined:** A pre-incorporation stock subscription is:

***“A contract authorizing an investor to purchase a set number of unissued shares from the corporation, at a future date, for a specific price, upon the issuance of such shares, after corporate formation.”***

**Promoters Role:** Subscriptions are offered and arranged by promoters with investors.

A promoter is ultimately, individually liable for the subscription contract with the investor, as the pre-incorporation stock subscription is made prior to the existence of the corporation.

Corporations will almost always ratify such stock subscriptions, thereby relieving the promoter of the liability.

As the promoter stands in a fiduciary relationship to the corporation, as well as to the investor purchasing the stock subscription, they are legally prohibited from making any secret profit at either of their expense.

**Terms of Subscriptions:** Pursuant to the business corporation law:

- ***Irrevocable for Three Months***
- ***Must Be In Writing and Signed by the Subscriber***
- ***Must Be Paid in Full***

**Importance of Subscriptions:** The sale of stock subscriptions is extremely important to a prospective corporation.

It is through the sale of these subscriptions that the corporation raises its initial capital, and sells its initial authorized shares.

# Corporate Formation Continued

## • Legal Process of Incorporation

- Incorporators
- Articles (Certificates) of Incorporation
- Mechanics of Incorporation

## • Incorporators

**Who Are Incorporators:** One or more natural persons of the age of 18 or over, who act as the incorporators of a corporation. [BCL §401].

These are the persons who sign and file the incorporation forms, including the certificate (articles) of incorporation, with the New York State Secretary of State.

**Role of Incorporators:** The role of the incorporators is to sign (with an acknowledgment) the certificate (articles) of incorporation.

They also deliver such certificate (articles) to the New York Department of State, whereupon the department of state files the certificate.

When the corporate existence has begun (after the Secretary of State files the Certificate of Incorporation), the incorporators hold an organization meeting, for the adoption of bylaws and the election of the first board of directors. [BCL §§402, 404]

## • Corporate Charters

The Corporate Charter contains three elements:

- The Articles of Incorporation;
- The Pre-Incorporation Documents; and
- The State Incorporation Laws.

## • Certificates of Incorporation:

The Certificate, sometimes also referred to as the Articles, of Incorporation is the legal instrument that creates the corporation. Like a constitution for government, it sets out the general framework of what the corporation is, and can later be amended.

**Contents:** The Certificate of incorporation must set forth the following:

- Name of the Corporation;
- Purposes of the Corporation;
- Office of the Corporation;
- Authorized Shares and Descriptions;
- Duration of the Corporation;
- Registered Agent;
- Designation of Secretary of State; and
- Limitations on Director's Liability (if any).

# Corporate Formation Continued

## • Mechanics of Incorporation

**Process of Incorporation:** One or more natural persons or corporations may act as incorporators of a corporation by signing and filing appropriate forms, including the certificate of incorporation, with the office of the secretary of state.

**Steps to Incorporate:** Forming a corporation involves three essential steps:

- **Creating the Certificate**
- **Signing the Certificate**
- **Filing the Certificate**

**Forming the Corporation:**

- **Certificate Must Be in the English Language;**
- **Certificate Must Be Signed and Acknowledged;**
- **Delivery Can Be By Mail, In Person or By Fax;**
- **Filing Fee of \$125 Required;**
- **Filing Not Discretionary - If Certificate Complies with Law, it Must Be Filed;**
- **Filing is Conclusive Evidence of Compliance with BCL;**
- **The Secretary of State Provides A Receipt Upon Filing;**
- **Corporate Existence Commences Upon Filing;**
- **Corporation Commencement Date Can Be Delayed if Requested.**

**No "Minimum Capital" Requirement:** In New York State, the Business Corporation Law does not contain any requirement that any particular minimum amount of capital be paid in before the corporation may commence doing business.

## • The Organizational Meeting – Generally

**Organizational Meeting Required:** After the corporate existence has begun, an organization meeting of the incorporator or incorporators must be held [BCL §403 (a)].

**Purpose of the Meeting:** The purpose of the meeting is for the adoption of by-laws, the election of directors to hold office until the first annual meeting of shareholders, the issuance of shares, and for the transaction of such other business as may come before the meeting.

**Time and Notice for the Meeting:** The meeting may be held at the call of any incorporator, who shall give at least five days' notice thereof by mail to each other incorporator, which notice shall set forth the time and place of the meeting. Notice need not be given to any incorporator who attends the meeting or submits a signed waiver.

**Quorum and Proxies:** A majority of incorporators shall constitute a quorum and the act of the majority present at a meeting at which a quorum is present shall be the act of the incorporators. An incorporator may act in person or by proxy.

**Alternative to Meeting:** Any action permitted to be taken at the organization meeting may be taken without a meeting if each incorporator agrees.

# Corporate Formation Continued

## • The Organizational Meeting – Issuance of Shares

Every corporation shall have power to create and issue the number of shares stated in its certificate of incorporation. The Certificate of Incorporation establishes the authorized shares.

**Defined:** Black's law dictionary defines a "*Share*" to be:

***"One of the definite number of equal parts into which the capital stock of a corporation is divided, and which represents and equity, ownership interest in the corporation".***

- ***Shares Must be Represented by Signed Certificates;***
- ***Certificates Are Only Evidence of Share Ownership;***
- ***Every Share Entitles Owner to One Vote;***
- ***Certificate of Incorporation Controls Stock Issuance (How Many Shares are issued)***
- ***Time and Manner of Issuance:***
  - The initial stock issuance generally takes place at the organizational meeting;
  - Such shares are "issued" by the board of directors, when, by board resolution, actually sell the stock to subscribing shareholders;
  - This sale takes place in accordance with subscriptions, which are made between promoters and prospective shareholders, and such stock purchases are recorded by the secretary so as to confirm the share's voting rights.
- ***Payment for Shares shall consist of money, property, labor or services;***
  - This payment by shareholders for the stock issued is how the corporation raises capital to operate the business for profit.
- ***Treasury Stock is shares which have been authorized but not sold to a shareholder;***
- ***Voting rights: Each share purchased entitles shareholder to cast one vote;***
  - Such vote applies to the election of members of the board of directors, as well as to certain corporate governance matters as set forth in the certificate.

## • The Organizational Meeting – Issuance of Shares

**Function of the Board:** Policy decisions of a corporation are made by a board or directors.

- ***Corporate Governance:*** This corporate "governance" is a "republican" form, whereby shareholders elect members of the board of directors, to represent them;
- ***Size of the Board:*** The size of the board of directors (how many members it contains) is generally contained in the certificate of incorporation, or in the by-laws;
- ***Board Meetings:*** Corporate action of the board of directors shall be taken at a meeting of the board;
- ***Meeting Notice:*** Notice of meetings of the board shall be made in accordance with the bylaws;
- ***Majority Vote Required:*** All decisions of the board, shall be accomplished by a majority vote;
- ***Written Resolutions Recorded:*** All actions of the board shall generally take the form of written resolutions;
- ***Length of Terms:*** The length of the term of the members is contained in the certificate or the bylaws;

**Election of the First Board of Directors:** The corporation's first board of directors is generally established by an election, overseen by the incorporators, held at the initial organizational meeting. Subsequent elections are held at the corporation's annual meeting.



# Corporate Formation Continued

## • The Organizational Meeting – Appointment of Officers

**Functions of the Board and Officers:** Where policy decisions of a corporation are made by a board or directors, such policy decisions are then implemented by appointed officers of the corporation, who act as the managers of the corporation.

- **Officers of the Corporation:** The corporation's officers perform the duties and responsibilities assigned to them by the board of directors for the management of the corporation;
- **Appointed by Board Resolution:** The certificate of incorporation may, but generally does not, provide for election of officers by the shareholders. Accordingly, officers are generally appointed by resolution of the board of directors, and include the following:
  - **Chief Executive Officer;**
  - **President;**
  - **Vice President(s);**
  - **Chief Financial Officer;**
  - **Treasurer; and**
  - **Secretary.**
- **Term of Office of Officers:** Unless otherwise provided in the certificate of incorporation or the bylaws, all officers shall be appointed to hold office until the meeting of the board following the next annual meeting of shareholders.

**First Appointment and Removal of Officers:** The first appointment of the initial officers of the corporation is often done at the organizational meeting, and any officer appointed by the board may be removed by the board with or without cause.

## • The Organizational Meeting – Adoption of Bylaws

**What are Bylaws:**

- Whereas the Certificate of Incorporation is like the Constitution of a Corporation, its Bylaws are like its Statutes.
- Bylaws are the rules and regulations enacted by a corporation to govern its affairs, and that of its shareholders, directors, and officers.
- Bylaws are adopted by the board of directors, when authorized by the certificate of incorporation, and by the shareholders when not so permitted.
- The Bylaws are subordinate to the general law of the state, the business corporation law, and the certificate of incorporation, and any provision of a Bylaw that conflicts with such superior authority invalid.
- Bylaws that are valid are binding on all shareholders, directors, officers and employees of the corporation, regardless of whether they know of the existence of those bylaws or were among the majority that consented to their adoption.

**When are Bylaws Adopted:** The initial Bylaws of a corporation are adopted by its incorporator or incorporators at the organization meeting.

Thereafter, Bylaws may be adopted, amended or repealed, pursuant to resolution, by a majority vote of the directors (if so permitted by the certificate of incorporation).

**What is Contained Within Bylaws:** The Bylaws may contain any provision relating to the business of the corporation, the conduct of its affairs, its rights or powers, or the rights or powers of its shareholders, directors, officers, or employees, not inconsistent with the business corporation law or any other statute, or the certificate of incorporation.