



Weekly Information Sheet 03

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.