Weekly Information Sheet 07

CORPORATIONS

Governance, Board of Directors, Personhood

1. Original Corporate Organization

• The Final Steps in Organizing the Corporation:

Once the articles of incorporation have been filed, there are some additional steps that must be followed to complete proper organization of the newly formed corporation. They include:

- **Initial organizational meeting**
- ***Creation and adoption of corporate bylaws***
- **Election of corporate officers**
- **Approval of shareholders agreements**
- ***Election of directors (if not named in the articles of incorporation)***
- **Banking resolution and fiscal year provisions**
- **Issuance of shares**
- **Annual reports**

• Organizational Meeting Generally:

The organizational meeting, or initial meeting, is the first official business of the newly formed corporation. The purpose of this meeting is to bring together the various members of the corporation, vote on officers, adopt by-laws, and take care of the other clerical work that must be done to officially launch the corporation.

• Election of Directors:

Members of the corporation who have shares entitling them to vote decide among themselves who they would like to elect to the board of directors. These directors will set the policies for the corporation and handle many other important decisions, including the payment of taxes, franchise fees, and changes in corporate procedures.

1. Original Corporate Organization Continued

• Appointment of Officers:

One of the first tasks the board of directors must accomplish is to vote on officers that will lead the corporation on a day to day basis. These officers include: Chief Executive Officer, President, Vice President(s), Chief Financial Officer, Treasurer and Secretary.

• Adoption of Corporate By Laws:

Whereas the Articles of Incorporation are similar to a Corporation's Constitution, the Corporation will also adopt By-Laws, which are similar to statutes. These By-Laws contain guidelines for how the business will be run and should make provisions for the following:

- ***The Date and Location of the annual shareholder meeting***
- ***The number of Directors***
- ***The authority, duties, and titles of corporate officers***

The By-Laws must be consistent with the articles of incorporation, and many courts have defined By-Laws as the essential contract between shareholders and the corporation.

• Shareholder Agreements and Banking Resolutions:

One of the first acts of the board of directors will also be the approval of shareholder agreements. Such approval will be made pursuant to any guidance that exists in the Articles of Incorporation.

Another of the first acts of the board of directors will be the approval of Banking Resolutions. Banking resolutions authorize the creation and maintenance of corporate bank accounts.

These resolutions will further limit who has access to corporate accounts, who is permitted to sign corporate checks, who is allowed to oversee the accounts, and how account reports will be made to the shareholders.

• Annual Report:

Corporations are required to file an annual report with the secretary of state's office listing the names and addresses of the officers and directors.

Such report details the operations and finances of the corporation, as well as its past substantive accomplishments and future aspirations.

Pursuant to the Sarbanes Oxley Act, the Chief Executive Officer and the Chief Financial Officer are required to certify the authenticity of the information contained in the annual report.

2. Corporate Governance

- ## General Issues:

Defined: Blacks law dictionary defined Board of Directors to mean:

"The governing body of a corporation, elected by the shareholders to establish corporate policy, appoint executive officers, and make major business and financial decisions."

Role: The role of the Board of Directors of a Corporation is as follows:

- ***Meet Regularly to Govern the Corporation:*** The Members of a Corporation's Board of Directors are the elected representatives of the shareholders, that meet regularly to govern the corporation.
- ***Provide Oversight for, and Make Policy of, the Corporation:*** The Members of a Corporation's Board of Directors provide general oversight and make policy of the corporation (similar to that of political system's republican, representative government) so as to serve as the governance power of the corporation. All policy decisions are thus under the dominion and control of the board of directors.
- ***Size of the Board of Directors:*** The number of Directors is fixed in the certificate of incorporation or when it is silent, the corporate Bylaws.
- ***Chair of the Board:*** Typically, the Board of Directors chooses one of its members to be the Chair of the Board, by majority vote. The Chair is the person responsible for presiding over the meetings of the Board. Such person provides leadership of the Board, often speaks for its actions, appoints the committees of the board, and exercises the additional duties and powers as provided in the Certificate of Incorporation, the Bylaws or by vote of the board.

- ## Manner of Corporate Governance / Management:

Corporation Governance and Management is a form of republican rule where shareholders elect directors to represent them.

Corporations must act through their employees, agents, officers and directors.

Shareholders are not authorized to sell corporate property, negotiate contracts on behalf of the corporation, or take individual action to hire and fire employees.

PART ONE: CORPORATE ELECTIONS:

Generally: Shareholders have the power to elect directors at the initial shareholders' meeting and then at every annual meeting thereafter. Control over the composition of the board is at the heart of the shareholders' governance role.

Procedures: Director elections occur pursuant to procedures outlined in either the certificate of incorporation, or the bylaws, or both, complying with procedural guidelines including notice, quorum and ballot requirements. Most election procedures allow for proxy voting.

Time of Election: The initial election is held at the organizational meeting, and then at the annual meeting of the corporation.

Nominations: Generally, the directors which run for election, are nominated either by the board of directors as a whole, or a nominating committee, or by the shareholders themselves.

Means of Voting: Depending upon the procedures in the Certificate of Incorporation and/or the Bylaws, the means of elections can be by either straight voting or cumulative voting.

Straight Voting: In straight voting, each share may be voted for as many candidates as there are slots on the board, but no share may be voted more than once for any given candidate. Directors are thereby elected by a plurality (not necessarily majority) of the votes cast, with each share casting only one vote per candidate running.

Cumulative Voting: To ensure board representation for larger minority shareholders, some corporations allow cumulative voting. In cumulative voting, minority shareholders can accumulate all of their votes, and allocate them among a few or even one candidate. This increases the chances of board representation for minority shareholders. It should be noted, however, that cumulative voting, however, only applies to electing directors, not to any other type of shareholder vote.

2. Corporate Governance Continued

• Manner of Corporate Governance / Management Continued:

PART TWO: THE SPECIAL ROLE OF DIRECTORS:

The members of a corporation's Board of Directors are the elected representatives of the shareholders. They meet regularly to govern the corporation.

The Board of Directors provide general oversight to serve as the governance power of the corporation.

Policy decisions are thus under their dominion and control. These decisions include:

- ***Hiring Officers;***
- ***Development / Approval of Strategic Plans;***
- ***Approving Policy Initiatives;***
- ***Approving SEC Filings and Annual Reports;***
- ***Acting on Mergers, Acquisitions and Dissolutions;***
- ***Approving Annual Budgets and Ensuring the Availability of Financial Resources; and***
- ***Establishing Compensation and Benefits for Officers and Employees.***

Courts will not interfere with the board's judgment in the absence of unusual conduct such as fraud, and a director has a duty of loyalty and is disqualified from taking part in corporate action when they have a conflict of interest.

PART THREE: OBLIGATIONS, DUTIES AND RESPONSIBILITIES

Obligations and Duties: A Corporation's Board of Directors have the following obligations and duties:

- ***Establish Ongoing Goals, Missions and Policies of the Corporation;***
- ***Hire and Oversee the Corporate Officers;***
- ***Delegate Duties to Officers, so as to Advance Corporate Policy and Goals;***
- ***Perform Corporate Planning and Strategy Development for Corporate Advancement;***
- ***Provide General Management of the Corporate Business, Policy, and Resources;***
- ***Determine and Monitor the Organization's Products, Services and Programs;***
- ***Enhance the Corporation's Public Image (so as to improve share value);***
- ***Assess the Performance of the Corporation and the Board Itself;***
- ***Avoid Conflicts of Interests and Keep Their Fiduciary Duty to Shareholders;***
- ***Provide Continuity of the Corporation; and***
- ***Account to Shareholders for the operation and Conduct of Corporate Business.***

PART THREE: OBLIGATIONS, DUTIES AND RESPONSIBILITIES (Continued)

Board of Directors' Responsibilities to Shareholders:

Fiduciary Duty: The primary responsibilities of board directors to shareholders relate to their fiduciary duties, including the duty of care, duty of loyalty and duty of obedience. These duties require board directors to place the best interests of the company ahead of their own. They must make decisions for the company and act in a manner that an ordinary, prudent person would. The duty of obedience requires boards to ensure that the company remains in compliance with all laws and regulations.

Quality Board Members Who Make Quality Decisions: Another responsibility that board directors have to shareholders is to compose and maintain a diverse, independent and highly competent board. Sound decision-making only comes from a wide variety of perspectives. Shareholders are entitled to know that the board overseeing the company's operations is well-qualified and up to the task.

Transparent Communication: Boards are required to take minutes of their meetings to detail the issues that they're working on. Shareholders may request copies of board meeting minutes if they're looking for assurance that the board is actively fulfilling their duties of oversight and strategic planning. This doesn't mean that shareholders have any say in directing the issues the board chooses to tackle or the way they prioritize issues.

Oversee a Financially Sound Corporation: Shareholders look for assurance that companies are financially strong currently and will continue to grow and prosper. The board of directors has an explicit responsibility to form a short-term plan of one to two years to ensure sustainability. In addition, shareholders are interested in long-term growth for continued security and prosperity.

Assure that Corporation Operates Consistently With Policy Goals: Board directors also have a responsibility to oversee all departments and aspects of the corporation. The responsibility includes making sure operations are running efficiently, company operations are in alignment with the organization's purpose, there are no incidences of fraud, they communicate the corporate culture throughout the organization, and they conduct oversight over all departments and operations of the company.

PART FOUR: DIRECTOR DUTIES AND LIABILITIES

Duties and Liabilities of Directors:

Liability: Directors have a unique relationship to the corporation, arising from their broad authority to manage and supervise the corporation's business and affairs, subject to the rights of shareholders. The liability and responsibility of Directors includes:

Fiduciary Duty: Corporate directors are said to owe fiduciary duties to the corporation itself as a separate and distinct artificial person under the law, and not to the particular shareholders who elected them. These fiduciary rules thus proceed from a theory of maximizing corporate financial well-being by focusing on shareholder wealth maximization.

Corporate Social Responsibility: Over the past decade, many companies have begun to assert that their responsibilities extend beyond the legal duties toward shareholders and others with whom the company does business, and have voluntarily taken responsibility for their impact on customers, workers, communities, and other stakeholders, as well as the environment. This attitude, however, can directly conflict with the true fiduciary duties of Directors to the Corporation itself and its shareholder owners.

PART FOUR: DIRECTOR DUTIES AND LIABILITIES (Continued)

Duties and Liabilities of Directors (Continued):

Duties of Care and Loyalty: According to traditional fiduciary analysis, corporate Directors owe two duties to the corporation: care and loyalty. Each duty describes standards for judicial review of corporate decision-making and fiduciary activities.

> ***Duty of Care:*** The duty of care addresses the attentiveness and prudence of Directors in performing their decision-making and oversight functions. The famous ***"business judgment rule"*** presumes that directors carry out their functions in good faith, after sufficient investigation, and for acceptable reasons. Unless this presumption is overcome, courts abstain from second guessing well-meaning business decisions even when they are flops. This is a risk that shareholders take when they make a corporate investment. Thus, to encourage directors to take business risks without fear of personal liability, corporate law protects well-meaning Directors, through exculpation provisions in the corporation's articles and Bylaws, as well as through directors' and officers' insurance.
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> ***Duty of Loyalty:*** The duty of loyalty addresses fiduciaries' conflicts of interest. This duty requires fiduciaries to put the corporation's interests ahead of their own. This means that fiduciaries cannot serve two masters. Corporate fiduciaries breach their duty of loyalty when they divert corporate assets, business opportunities, or proprietary information for personal gain. Accordingly, courts will not interfere with the board's judgment in the absence of unusual conduct such as fraud, and a Director has a duty of loyalty, and is disqualified from taking part in corporate action, when they have a conflict of interest.

PART FIVE: CORPORATE PERSONHOOD

Corporate Personhood: As declared since the famous case of Dartmouth College v. Woodward, is the legal principle that a corporation is an Artificial Person under the law, with many of the same rights and privileges as a natural person.

Corporations Have Their Own Separate Legal Status: Pursuant to the concept of corporate personhood, corporations are deemed as legally separate from their associated human beings (shareholders, directors, officers and employees), and have their own constitutionally protected rights.

Rights of the Corporation: As separate legal persons, corporations have a right to enter into contracts with other parties, to sue or be sued in court in the same way as natural persons, and enjoy most constitutional rights traditionally associated with natural persons. The constitutional rights they **DO NOT** have include:

- **Corporations cannot vote in political elections;**
- **Corporations are not citizens under the Fourteenth Amendment;**
- **Corporations lack Fifth Amendment self-incrimination rights;**
- **Corporations are not given Privileges and Immunities under Article IV;**
- **Corporations are not afforded Due Process Clause Liberty Rights; and**
- **Corporations obviously due not have the human rights to serve on juries, run for political office, marry, procreate, or travel.**

More on Corporate Personhood: Since the time of their establishment under Roman Law, Corporations have been held to be, and have been viewed as, an Artificial Person Under the Law. This Corporate "Personhood" means that the corporation is viewed as a separate entity, distinct from its shareholder owners, and managing board of directors and officers.

Powers of a Corporation: Because of its status as an artificial person under the law, corporations have many, distinct entity powers. This means a corporation can contract in its own name, sue or be sued, own or convey property, and be held criminally liable for crimes that it commits. (BCL §202).

Certificate of Incorporation: Unless the certificate of incorporation expressly limits the corporation's powers, it will be deemed to have the power to engage in any lawful business activity.

Meaning of Corporate Rights: Corporate personhood refers to the ability of corporations to be recognized as an artificial person under the law, with certain constitutionally protected rights. One of these critical rights is the power to act as a person under the law, and thereby enter into contractual agreements and to bring and defend litigation in its own name. Corporate personhood is also linked to the concept of limited liability, as it is the corporation that enters into contracts and take on debt and risk, not the individuals who work for the corporation or the shareholders who own its stock.