



Weekly Information Sheet 09

CORPORATE GOVERNANCE

Corporate Governance

• General Issues:

A Corporation must act through its employees, agents, officers and directors. These individuals are important members of a corporation, but the corporation exists separately from them. A Corporation Consists of:

- **Shareholders:** A shareholder is a person who owns shares in a corporation. A "share" is literally the physical representation of a predetermined amount of the business. As owners, these stockholders have the right to control the corporation through the election of directors and through other proposals brought to a vote. Ordinarily, stockholder action is taken at a regular or special meeting of the stockholders. Shareholders cannot have their percentage of ownership diluted.
- **Officers:** An individual hired or selected by a board of directors who has specific authority, such as the ability to bind the corporation to contracts and other agreements, and who carries out the day-to-day activities of the business.
- **Directors:** Individuals who set policy and long-term goals for corporations. These Directors are elected by Shareholders and set the policies for the corporation and handle many other important decisions, including the payment of taxes, franchise fees, and changes in corporate procedures. Directors also select, appoint and hire the Officers of the corporation.

• 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.

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;**
- **Management of the business policy of the corporation**
- **Control of the policy of the business; and**
- **Delegation of duties to officers to put policy into practice**
- **Approving Policy Initiatives;**
- **Approving SEC Filings and Annual Reports; and**
- **Acting on Mergers, Acquisitions and Dissolutions.**

The number of Directors is fixed in the corporate bylaws or the articles of incorporation.

Courts will generally 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.

Directors have authority to manage the corporation.

They may enter into any contract or transaction necessary to carry out business.

They may appoint officers and other agents to act for the company, and may appoint several of its own members as an executive committee to act for the board between meetings.

1. Corporate Governance Continued

• Manner of Corporate Governance / Management Continued:

DIRECTOR DUTIES AND LIABILITIES CONTINUED:

Liabilities of Directors:

Directors also have **Liabilities**. They must act in a fiduciary capacity in dealing with the corporation. The Business Judgment Rule provides a defense for Directors who act in good faith and who have exercised reasonable care.

Directors and Officers are generally not liable for corporate obligations and debts.

Directors also owe a **fiduciary duty** to their shareholders and to the corporation as a legal entity under the law. A fiduciary is someone who has ethical, moral, and financial duties to act in the best interests of another (in this case the corporation).

Directors must avoid **Conflicts of Interest**.

The fiduciary duty imposed on directors is straightforward. Directors owe the corporation an undivided loyalty that prohibits them from self-dealing and conflicts of interest.

Accordingly, Directors further have a **duty to refrain from** doing anything in their capacity as director of a corporation that would:

- **Injure the corporation's interests,**
- **Deprive the corporation of profit, or**
- **That would allow the director to take personal advantage of corporate information.**

Directors work for, and are elected by, the Shareholders. Since shareholders elect the directors, they also have the power to remove them as specified in the ByLaws or Articles of Incorporation.

Shareholders most often have the right to remove a director for "good cause," such as a proven allegation of fraud or embezzlement.

• **Corporate Officers:**

The Officers of a corporation, are selected and removed by the board of directors. Officers are agents of the corporation with specific, actual authority, and with powers governed by the law of agency.

Their relations with the corporation are fiduciary in nature, and they are liable for any secret profits and for diverting corporate opportunities to their own advantage.

Officers of a Corporation Include:

- **Chief Executive Officer**
- **Vice – President;**
- **Treasurer; and**
- **President;**
- **Chief Financial Officer;**
- **Secretary.**

Officers vs. Agents:

Officers are employees of the corporation who have general duties.

An Agent, on the other hand is a broad term encompassing any individual who works, even temporarily, for another's interest. As a result, all officers are agents, but not all agents are officers.

Corporate Officers – What they do

1. Chief Executive Officer:

This is the highest ranking officer in the corporation – responsible as the corporation's lead agent, and performs the following duties:

- **Decides whom to hire and fire as agent or employee;**
- **Responsible for the day to day management of the business;**
- **Oversees the other employees (and to limited extent other officers as they are appointed and overseen by directors);**
- **Signs contracts on behalf of the corporation;**
- **Negotiates on behalf of the corporation (pursuant to the parameters set by the board of directors);**
- **Delegates his authority to other officers or employees (as allowed by the board of directors); and**
- **Is Responsible under the Sarbanes Oxley Act for the signing and verification of corporate reports (such as annual reports)**

1. Corporate Governance Continued

• Corporate Officers Continued:

Corporate Officers – What they do

2. President:

If there is no separate Chief Executive Officer, the president is the highest ranking officer in the corporation – and is responsible as the corporation's lead agent, and performs the duties as set forth previously for the CEO, or as assigned by the corporate bylaws or the Board of Directors.

3. Vice President:

Corporate vice-presidents generally have very little to do with the day-to-day function of a corporation. Usually, they are only authorized to take action in specific situations, such as when the corporate president is unavailable.

Sometimes they are the head of a division the corporation or set in charge of a function (such as Head of Light Bulb Manufacturing Division or Consumer Affairs/Relations)

4. Chief Financial Officer:

The Chief Financial Officer or CFO is the officer responsible for the finances, and accounting of the finances, of the corporation.

Together with the Chief Executive Officer, the CFO must also verify the accuracy of reports under the Sarbanes Oxley Act.

5. Treasurer:

If the corporation does not have a separate, Chief Financial Officer, the treasurer serves as the officer responsible for the finances, and accounting of the finances, of the corporation.

They are the officer responsible for maintaining records of the corporation's finances and ensuring that all corporate checking accounts, revenues, and accounts receivable are accurate and up-to-date.

6. Secretary:

The Secretary is the officer responsible for the maintaining nonmonetary records for the corporation.

The corporate secretary is responsible for sending out/transmitting all notices and documents from the corporation. They are also the officer that keeps the corporate seal, and who keep all records of the shareholder and directors' meetings.

The secretary must also ensure that proper documentation is filed with the state secretary of state's office, or any other required corporate filing.

• Corporate Employees:

Generally:

Generally, directors and officers are not liable for corporate obligations or debts.

A corporation itself, however, is civilly liable to a third party if one of its agents causes injury.

Corporate Employees:

Employment Defined: Black's Law Dictionary defines "Employment" as:

1. Act of employing or state of being employed; or
2. That which engages or occupies; or
3. That which consumes time or attention; or
4. An occupation, profession, trade, post or business.

A Simple definition of "Employment" is:

"An act to engage or hire one's service, in return for payment for such service."

The Labor Law's Definition of "Employment" is:

A relationship where someone is "permitted or suffered to work"

Corporation Employees: Has been held to include all individuals who are employees of Corporation, including unionized (collectively bargained), non-unionized (non collectively bargained), part-time, full-time employees, or individuals engaged on contract to provide employment services or sales to Corporation.

1. Corporate Governance Continued

• Corporate Employees Continued:

- Employees are the persons who actually perform the day to day work of the corporation, under the oversight of the Corporate Officers.
- Employees of a corporation, are selected and removed by the Corporate Officers.
- Employees of the corporation are vested with specific, actual authority, and with powers governed by the law of agency.
- Employees, like Officers, are personally responsible for any torts or crimes they commit even if they act on behalf of the corporation.
- Employees, like Officers, may be liable for taking advantage of a corporate opportunity.
- The primary difference between an employee and an officer of the corporation is that employee is an individual who merely provides professional or manual work to a corporation while an officer has a position of authority in the corporation's hierarchical organization.
- Employees of the corporation are agents hired and paid by the corporation, to perform its functions, as directed by the corporation's officers.
- Their employer is the corporation itself.
- The corporation is generally liable for their actions.
- Employees are hired, and may be discharged, by the corporation's officers.

• Corporate Agents vs. Corporate Employees:

- Employees of the corporation have a permanent status, and are paid regular wages or salaries by the corporation for their work and duties.
- Agents, on the other hand, is a broad term encompassing any individual who works, even temporarily, for another's interest.
- As a result, all employees are agents, but not all agents are employees.

• Roles, Duties and Liability of Corporate Employees:

- **Corporate Employees** – Although Corporate Employees are employees of the corporation, they are hired by the corporate officers, and perform the roles and duties assigned to them by the corporate officers.
- **Only Provide Delegated Management Role:** They play no role in the management or decision making of the corporation, other than to manage other employees or to make decisions delegated to them by the corporate officer to whom the employee reports.
- **Agency Principles Govern:** The authority, rights, and liabilities of an agent or employee of a corporation are governed by the same rules as those applicable when the principal or employer is a natural person. As a result, the authority of corporate employees is also governed by general agency principles.
- **No Shielded Protection:** The fact that a person is acting on behalf of a corporation does not serve as a shield from the liability that would be imposed for acts done on behalf of a natural person.
- **Indemnification:** Corporations are empowered to indemnify these persons if they acted in good faith and in a manner reasonably believed to be in, or not opposed to, the interests of the corporation and had no reason to believe that their conduct was ultra vires or unlawful.

• Corporate Agents:

- **Corporate Agents** – As an artificial person under the law, corporations must act through agents. The conduct of agents is governed by the law of agency.
- **Agency Defined:** Black's Law Dictionary defines the term "Agency" as follows:
"A fiduciary relationship created by express or implied contract or by law, in which one party (the agent) may act on behalf of another party (the principal) and bind that other party by words or actions."
- **Agency Principles Govern:** The authority, rights, and liabilities of an agent of a corporation are governed by the same rules as those applicable when the principal or employer is a natural person. As a result, the authority of corporate agents is also governed by general agency principles.
- **Temporary Role:** Unlike an employee, who holds a permanent status by means of regular paid salary or wages by the corporation, an agent relationship tends to be more of a task related relationship, whereby payment and authority exist only for the performance of the task assigned.
- **Indemnification:** Corporations are empowered to indemnify these persons if they acted in good faith and in a manner reasonably believed to be in, or not opposed to, the interests of the corporation and had no reason to believe that their conduct was ultra vires or unlawful.

1. Corporate Governance Continued

• Running the Corporation:

- **Board of Directors:** The New York Business Corporation Law, as well as the articles of incorporation and the by laws of the corporation, provide broad powers to the board of directors to manage and run the corporation. They are the policy making entity for the corporation and hire the corporate officers who provide the day to day management of corporate affairs.
- **Meetings of the Boards of Directors:** The Board of Directors operates by means of meetings of the board. Agendas for such meetings are prepared by the Chair of the Board. Business of the board, and policy decisions made by the board, is accomplished by resolutions adopted by the board at their meetings.
- **Size of the Board of Directors:** The size of the board of directors is established in the articles of incorporation or the by-laws. Such size is a balancing test between the need for broad talent and diverse opinions and the need to have a manageable size so as to not make meetings unwieldy. Corporate Governance Expert **Ira Milstein, has declared that seven persons is the perfect balance for board size.** But due to regulatory requirements, corporate committee needs, and modern board duties, most boards are far larger than seven, so as to accommodate and more fairly such workloads and duties.
- **Officers:** The board of directors appoints officers and other agents to act for the company, to do the day to day work of the corporation, in accordance with board directives and policies. To accomplish the work of the corporation, the board grants broad powers to its officers to do the work they are assigned. The **Chief Executive Officer**, is the primary corporate manager, and pursuant to board policy and directive, is the person responsible for carrying out the day to day responsibilities of the company, and assuring that the purposes and goals of the corporation are achieved.

• Enforcement of Board Policies:

- **Board Policies:** The Corporate Officers are the persons most generally responsible for the implementation and enforcement of policies adopted by the Corporation's Board of Directors. As the day to day managers of the Corporation, the Officers are responsible for the board policies under their area of responsibility, and are overseen and held accountable by the board of directors for their performance
- **Execution of Board Action:** If the Board of Directors decides to expand into a new product line or area, or discontinue a previously authorized corporate activity or mission, it is the officers of the corporation that must act to make this decision a reality, including the purchase or sale of materials and expansion or reduction of employees incumbent with such a directive. Officers are generally given broad discretion as to how to accomplish these board directives and policies.

• Employee Management:

- **Oversight of Corporate Employees:** The Corporate Officers are the persons responsible for the oversight and management of all the corporate employees. The officers hire, fire and manage the corporation's employees so as to carry out the corporation's purposes and accomplish the directive and policies of the board of directors.
- **Employee Administration:** Corporate Officers, especially the Chief Executive Officer, provide employee administration, including tasking employees, defining employee roles, establishing and administering employee salaries, wages and benefits, granting employee raises, levying employee discipline, determining workforce strength, directing employee missions, and examining and reporting on employee productivity.

• Shareholder Derivative Law Suits:

- A shareholder derivative suit is a lawsuit brought by a shareholder on behalf of a corporation against a third party. Often, the third party is an insider of the corporation, such as an executive officer or director. Shareholder derivative suits are unique because under traditional corporate law, management is responsible for bringing and defending the corporation against suit. Shareholder derivative suits permit a shareholder to initiate a suit when management has failed to do so. It should be noted, that if the shareholder wins the action, it is the corporation, and not the shareholder who is awarded the recovery.