

CCCBA Business Law Section proudly presents...

**The Curious Corporation of Benjamin Button:
Corporate Formalities, Compliance and Succession
Planning**

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AGENDA

- I. Introduction of speakers
- II. What are corporate formalities and why are they important to observe?
- III. Patient #1: The Dated Corporation
 - Client consultation
 - Diagnosis/ Review and evaluation of corporate records
 - Treatment plan
- IV. Patient #2: The Non-Profit
 - Client consultation
 - Diagnosis: Review and evaluation of non-profit records
 - Treatment plan
- V. Limited Liability Company Formalities & Best Practices
- VI. Patient #3: The Divorcee
 - Client consultation
 - Diagnosis/ Review and evaluation of LLC records
 - Treatment plan
- VII. Questions

 Contra Costa County
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PROGRAM MATERIALS

The Curious Corporation of Benjamin Button – Corporate Formalities, Compliance and Succession Planning

Three different corporate clients come into to see you. While each client has their own unique concerns regarding the business entity, what they all have in common is that the entities are rather old, showing signs of decay and ill-health (although the clients don't seem to think so) and the clients are now asking you, as the Juris Doctor, what can be done? Our panel will look at these three separate business entities and start with triage and stabilizing the companies and move into addressing the specific concerns such as succession planning for retirement, divorce of an owner and maintenance of a non-profit's tax exempt status.

1. Corporate Formalities

I. What are corporate formalities?

- Enforced by law
 - Annual shareholder meetings (Cal. Corp Code § 600)
 - Regular election of directors (Cal. Corp Code §§ 301, 600)
 - Shareholder and Board of Directors meeting minutes (Cal. Corp Code § 1500)
 - Maintaining accurate corporate books and records (Cal. Corp Code §§ 1500, 17701.13)
 - Filing of Annual/Bi-Annual Statements of Information (Cal. Corp Code § 1502)
 - Required Officers: Chairman of the Board/President, Secretary and Chief Financial Officer (Cal. Corp Code § 312)
 - LLCs required to adopt an Operating Agreement (Cal. Corp Code § 17701.02(s))
- Enforced by Corporate Governing Documents
 - Time and place of meetings of the shareholders and board
 - Procedures for holding meetings: notice, voting, written consents in lieu of meeting
 - Number of authorized Directors
 - Additional officers other than those required by law

II. Why should corporate formalities be observed

- Promotes good record keeping practices
 - Accurate records become important in the event of:
 - Lawsuit
 - Sale of shares/membership interests
 - Sale of entire business
- Limitation of Liability - preservation of the corporate veil
 - observation of corporate formalities evidences that the business entity is not a sham or “alter-ego” of its owners

2. Patient 1: The Dated Corporation

I. The Consult

- Request:
 - Corporate book
 - Articles
 - Bylaws
 - S-Corporation Election (if applicable)
 - Shareholder Agreement(s)
 - Shareholder and Board of Directors' minutes/written consents
 - Stock Certificates
 - Stock Ledger
 - Capitalization Tables
 - Statements of Information
- Learn:
 - The corporation's line of business
 - Where does the corporation do business and/or where is it registered to do business (State/County)?
 - The fictitious business names registered by the corporation
 - Identities of any parent and/or subsidiary companies
 - Identities of key officers, directors and shareholders
 - What are the client's succession goals?
 - What succession planning does the client already have in place?

II. The Diagnosis – Review and Evaluation of the Corporate Records

- Articles
 - Verify date filed with the Secretary of State (“SOS”)
 - Locate any amendments to the Articles
 - Verify the name of the corporation as registered with the SOS
 - Note the number of authorized shares of the stock of the corporation
- Bylaws
 - Verify the principal office of the corporation
 - How many directors are mandated by the Bylaws?
 - When (at what frequency) and where are meetings of the Shareholders and the Board of Directors to occur?
 - What officer roles are required by the Bylaws?
 - What policies exist for vacancies on the Board and/or in officer roles?
 - Locate any amendments to the Bylaws
- Most Recent Statement of Information
 - Verify status of the corporation with the SOS – Past due statements of information? Suspension by SOS or FTB?
 - Verify the principal and mailing addresses of the corporation as reported to the SOS
 - Verify agent for service of process and the agent's address
 - Note the current Officers and Directors as reported to the SOS
- Shareholder and Board of Directors' minutes/written consents

- Has the corporation observed annual shareholder meetings?
- Has the corporation kept minutes for each annual shareholder meeting?
- Do the last minutes or written consent(s) of the Shareholders, electing the Directors, match the Directors listed on the current statement of information?
- How often does the Board meet?
- Has the corporation kept minutes for each meeting of the Board?
- Do the last minutes or written consent(s) of the Board, electing the officers, match the officers listed on the current statement of information?
- Have any minutes of the shareholders and/or the Board been lost, misplaced or destroyed?
- Stock Certificates/ Stock Ledger
 - How many classes of Stock are there?
 - How many total shareholders are there?
 - Who are the shareholders? (individuals, entities, trusts?)
 - How many total shares have been issued vs how many shares authorized?
- Shareholder/Buy-Sell Agreement(s)
 - What are the terms agreed upon by the shareholders governing the transfer and sale of shares of the stock of the corporation?
 - What types of transfers are permissible?
 - What type(s) of Consent(s) are necessary to make a transfer/sale of shares?
 - Does the Company and/or the other Shareholders have a right of first refusal?
 - Does the Company and/or the other Shareholders have a right or obligation to purchase the shares of another shareholder upon his/her/its death, divorce, disability and/or termination of employment?

III. Treatment Plan

- Compliance with corporate formalities
 1. Cure any suspension statuses with the SOS or FTB – pay late fees etc.
 2. Register the corporation to do business in any other state(s) where it currently does business but is not already registered
 3. Apply for any fictitious business names, under which the corporation is currently doing business as, in the county in which the fictitious business name is being used
 4. Determine whether the corporation has the same number of Directors required by law and/or the Bylaws
 - Cal. Corp. Code § 212, requires whenever a corporation has one (1) shareholder, the corporation shall have at least one (1) member of the Board of Directors; in the event that the corporation has two (2) shareholders, then the corporation shall have at least two (2) members of the Board of Directors; and in the event that the corporation has three (3) or more shareholders, then the corporation shall have at least three (3) members of the Board of Directors.
 5. If necessary amend the Bylaws to provide for a different number of directors to suit the needs of the corporation
 6. Determine whether there are any officer vacancies
 - Cal. Corp. Code § 312 requires all corporations to have “a chairperson of the board, who may be given the title of chair of the board, chairperson of

the board, chairperson, or a president or both, (2) a secretary, (3) a chief financial officer, and (4) such other officers with such titles and duties as shall be stated in the bylaws”

7. Conduct a diligent search for any missing minutes of the Shareholders and/or the Board
 8. If there are missing minutes, prepare a declaration of the corporation’s Secretary attesting to the search efforts and despite such efforts the relevant minutes have been lost, misplaced or destroyed
 9. If officer and/or director vacancies need to be filled, notice and hold meetings of the Shareholders/Board to elect the officer(s) and/or Director(s) OR execute a written consent of the Shareholders/Board, in lieu of a meeting as permitted by Cal Corp Code §§ 307(b), 603
 10. If it is the proper time, notice and hold the annual meeting of the Shareholders
 - o At minimum, Cal. Corp. Code § 600(b) requires annual shareholder meeting for the election of the directors
 11. File an amended Statement of Information listing the current address(es), Agent, Officers and directors of the corporation
 12. Update the corporation’s stock ledger
 13. Issue any stock certificates which are recorded on the ledger but have not yet been issued and cancel any certificates that have yet to be cancelled
 14. If additional shares of stock are necessary, prepare and file an amendment to the corporation’s Articles
- Succession Planning for Retirement
 1. Define a reasonable timeline for the succession of the client (as a shareholder, officer and/or director)
 2. Determine, with the client, if any transfer or sale of shares is currently being contemplated (i.e. transfer from an individual to one’s trust, gift from the client to their children, sale of shares to another existing shareholder or third party, etc.)
 3. If a transfer/sale is being considered, determine if the proposed transfer/sale conforms with the corporation’s procedures found in its governing documents and determine the best method to execute the transfer/sale
 4. If necessary prepare a Buy-Sell/Shareholder Agreement or amend and restate the Buy-Sell/Shareholder Agreement to better suit the needs of the corporation and its Shareholders
 5. Prepare transaction documents relating to the proposed transfer/sale (i.e. gift agreements, assignments, stock purchase agreements and written consents of the Shareholders and the Board authorizing and ratifying such transactions)
 6. Give notice of any officer(s) and/or Director(s) intent to resign from their roles so any vacancies can be promptly filled
 7. Prepare any necessary employment and/or consulting agreements for continued consulting services following succession

3. The Non Profit

I. The Consult

- Request:
 - Corporate book
 - Articles
 - 501(c)(3) tax exempt letter
 - Federal Tax ID Number
 - State Tax ID Number
 - Bylaws
 - Conflict of Interest Policy
 - Board of Director's meeting minutes/written consents
 - Last 990 EZ forms
 - Last CT-1
- Learn:
 - The non-profit's exempt purpose
 - Identities of any parent and/or subsidiary companies
 - Identities of key officers and directors
 - Where the Non-profit/charity does business (i.e. in what states)
 - States the nonprofit is soliciting donations within/ what states it has registered within for charitable solicitation

II. The Diagnosis

- Review tax and corporate documents to determine appropriate status as a non-profit
- Perform a Franchise Tax Board Search
- Perform a California non-profit search
- Identify the current governing documents in place
- Identify the current directors and officers

III. Treatment plan

- Determine which documents are missing and which were never filed
- Remedy and deficiencies concerning tax exempt status
 - Work with CPA to file taxes. 990 EZ AND CA CT-1 Cards
 - Apply for federal tax exemption - File 1023 EZ with IRS
 - Apply for California tax exemption with the California Franchise Tax Board - File CA form 3500A
- Prepare and adopt any missing corporate governance documents
 - Bylaws should be adopted in order to govern the operations of the nonprofit (Cal. Corp Code § 5151)
 - While not required by law, it is best practice to adopt a conflict of interest policy
 - The non-profit will be required to describe its policy regarding conflicts of interest in IRS Form 1023
- Hold a meeting (can be a consent in lieu) resolving to grant authority to create a viable nonprofit, adopt governance documents, and elect directors and officers

4. Limited Liability Companies (“LLC”)

IV. LLC corporate formalities

- LLCs generally have less compliance requirements than corporations
 - No annual meetings & minutes required
 - Most actions of the Members and/or Managers do not require a written consent
- LLCs are required to file Statements of Information with the SOS bi-annually
- LLCs are required by law (Cal Corp Code § 17701.13(d), (e)) to Maintain Accurate records including:
 - Current list of the full name and last known address of each member including contributions and share in profits and losses of each member
 - If manager-managed, current list of full name and address of each manager
 - Copy of the Articles of Organization and all amendments thereto
 - Copies of federal, state, and local income tax or information returns and reports, if any, for the six (6) most recent fiscal years.
 - A copy of the limited liability company’s operating agreement, if in writing, and any amendments thereto
 - Copies of the financial statements of the LLC, if any, for the six (6) most recent fiscal years.
 - The books and records of the LLC as they relate to the internal affairs of the limited liability company for at least the current and past four fiscal years.
 - True copies of business records evidencing the amount, cost, and value of all property owned, claimed, possessed, or controlled by the LLC
- The vote of all of the Members of an LLC is required to take the following action whether member or manager managed (Cal Corp Code § 17704.07 (c)(4)):
 - Sell, lease, exchange, or otherwise dispose of all, or substantially all, of the LLC’s property
 - Any act outside the ordinary course of the LLC’s business activities
- Best practice is to prepare written consents documenting
 - The vote and/or action of all or the majority of the Members
 - The consent of the Managers as to consequential business decisions
- Most LLC compliance requirements will be dictated by the LLC’s Operating Agreement

5. The Divorcee

V. The Consult

- Request:
 - Corporate binder
 - Articles of Organization
 - Operating Agreement
 - Minutes/written consents of the Members/Managers
 - Membership Interest Ledger
 - Capitalization Tables
 - Statements of Information
 - Marriage Settlement Agreements
 - Family Law Court Orders

- Learn:
 - Was the client's ownership in the LLC acquired before or during the marriage?
 - What is the ex-spouse's relationship to the LLC, if any? (i.e. employee, officer, Member)
 - The client's goals for the LLC (i.e. protect assets from ex-spouse, keep control of the company, sell shares and/or resign from officer positions)
 - How are the client's membership interests held? (i.e. individually, jointly, through a trust)
 - What agreements have already been reached between client and ex-spouse concerning the LLC?
 - Identities of key officers, directors and shareholders

VI. The Diagnosis

- Confirm filing of Articles of Organization & verify date filed
- Verify standing with the SOS and FTB
- Verify tax status (partnership vs. sole proprietor)
- Confirm the lack of governing documents

VII. Treatment plan

- California Law requires that LLC's have an operating agreement, whether oral or written, and whether referred to as an "Operating Agreement" or not (Cal Corp Code § 17701.02 (s))
- California law does not require LLCs to adopt a *written* operating agreement
- An operating agreement is *highly* advisable and a best practice for LLCs
- An operating agreement outlines the:
 - management structure,
 - member roles and responsibilities,
 - operating procedures of the LLC
 - defines rules and regulations that govern the relationships between its members.
- LLCs that do not adopt an Operating Agreement will be bound by the "default rules" provided by the California Revised Uniform Limited Liability Company Act, found in the corporations code § 17701.01-17713.13 (Cal. Corp Code §17701.10(b))
- The default rules will also apply if the LLC has an Operating Agreement but the agreement is silent on a particular issue (Cal. Corp Code §17701.10(b))
- Divorce:
 - Propose a Buy-out or Redemption
 - One (1) spouse can purchase the interests of the other spouse paying the selling spouse fifty percent (**50%**) of what the LLC's value
 - One Spouse may concede an interest in another asset (perhaps a family house or a retirement account) as a means of equalizing the division of assets.
 - The Company may "redeem" one (1) spouses interests in the LLC leaving the other spouse as the sole member of the LLC
 - Depending on the terms agreed to between the spouses, prepare purchase transaction documents

- Succession planning/ future of the LLC:
 - Prepare a written consent of the Manager, authorizing the purchase transaction documents
 - Update the LLC's records including:
 - Membership list
 - Membership Interest Ledger
 - Capitalization tables
 - If necessary, file updated Statement of Information with the SOS
 - Prepare an Operating Agreement to fit the needs of the business and allow flexibility for the future
 - Prepare a written consent of the Manager adopting the Operating Agreement