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ATTORNEYS AND COUNSELORS

Five Reasons to Play by the Corporate Rules

by Michael C. Gibbons



Most businesses operate using a formal legal entity (either a corporation or a limited liability company.) [This article will refer to corporations since those entities remain more commonly used and their formalities are more settled.] The applicable corporate statutes and case law, and good practice generally, set forth corporate rules as to how certain actions should be taken by business owners (Shareholders) and managers (the Board of Directors.)

General speaking, actions to be taken by Shareholders (for example, electing the board of directors) can be accomplished either by voting at a formal shareholders meeting or by signing a resolution (usually

unanimous) in lieu of the meeting. Important management decisions that are typically made by the board of directors (for example, election of officers or setting executive compensation) can be accomplished in the same fashion. Formal notes (minutes) of meetings should always be taken to summarize the discussions and decisions, usually by the corporation's secretary or corporate counsel in attendance.

More often than not, small-to-mid size businesses either ignore these simple requirements or honor them in the breach. This is a mistake on many levels.

Failure to Comply Could Expose the Owner to Personal Liability.

To begin with, these steps are required by law. They are part of the bargain that the business makes in order to enjoy the liability protection of the "corporate shield." Failure to do so may be used by third parties (including the government) to

"pierce the corporate veil" and impose individual liability on the shareholders.

Formal Meetings Benefit the Company.

Putting aside the liability issue, holding Shareholder and Board meetings can be very productive (as can documenting actions with resolutions, to a lesser degree.) Sitting in the same room permits information and ideas to be exchanged, questions to be answered, and grievances to be aired and resolved.

Records Evidence and Support the Decisions That Were Made.

Regular meetings or consent resolutions provide an **excellent historical record of all important actions** taken by or on behalf of the business. They also confirm that there was agreement on those decisions and actions should a dispute later arise, and confirm exactly who agreed or disagreed. Disgruntled shareholders often have fuzzy, if

not revisionist, memories.

Should serious disputes develop, holding regular meetings goes a long way to establishing that shareholder's rights were honored, and that shareholders have not been "frozen out" of the corporation.

Other Business Parties Expect You to Follow the Rules.

Sophisticated business partners like financial institutions, landlords, and benefit plan administrators often require formal corporate documentation of the many actions taken in your dealings with them, from execution of bank loans to appointments of plan fiduciaries to verifying the authorized Officers of the corporation. This avoids later arguments over whether the actions were authorized and **assures that the agreements that are in place will be viable and enforced** if necessary.

Should the business owners ever decide to sell the business, **potential buyers will always**

expect to review these records as a part of their due diligence. The lack of good corporate records is an indication to buyers (whether or not true) that the business is not well managed. Thorough, regularly kept corporate records sends the opposite message. At a minimum, the failure to do so raises questions and creates additional work in order to move forward with the due diligence and sale.

It is Relatively Simple to Do.

Obviously, it is best to keep good corporate records from the beginning. However, like personal health and fitness, it is never too late to start. In fact, it is simple. Consider including corporate counsel to make sure the meetings are properly scheduled and noticed.

- Schedule an annual meeting of the Shareholders and the Board of Directors;
- take minutes of those meetings;

- consider holding Board meetings intermittently throughout the year;
- and significant actions are taken during the year, consider whether a short Board meeting or written Board resolution should be used to document and approve the actions.

Make these a habit, and you will find that they become easier and invaluable to every business.

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