

SUBJECT: CORPORATION LAW  
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## **INCORPORATING UNDER THE NEW MINNESOTA INCORPORATION ACT**

**By Richard A. Saliterman**

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# THE HENNEPIN LAWYER

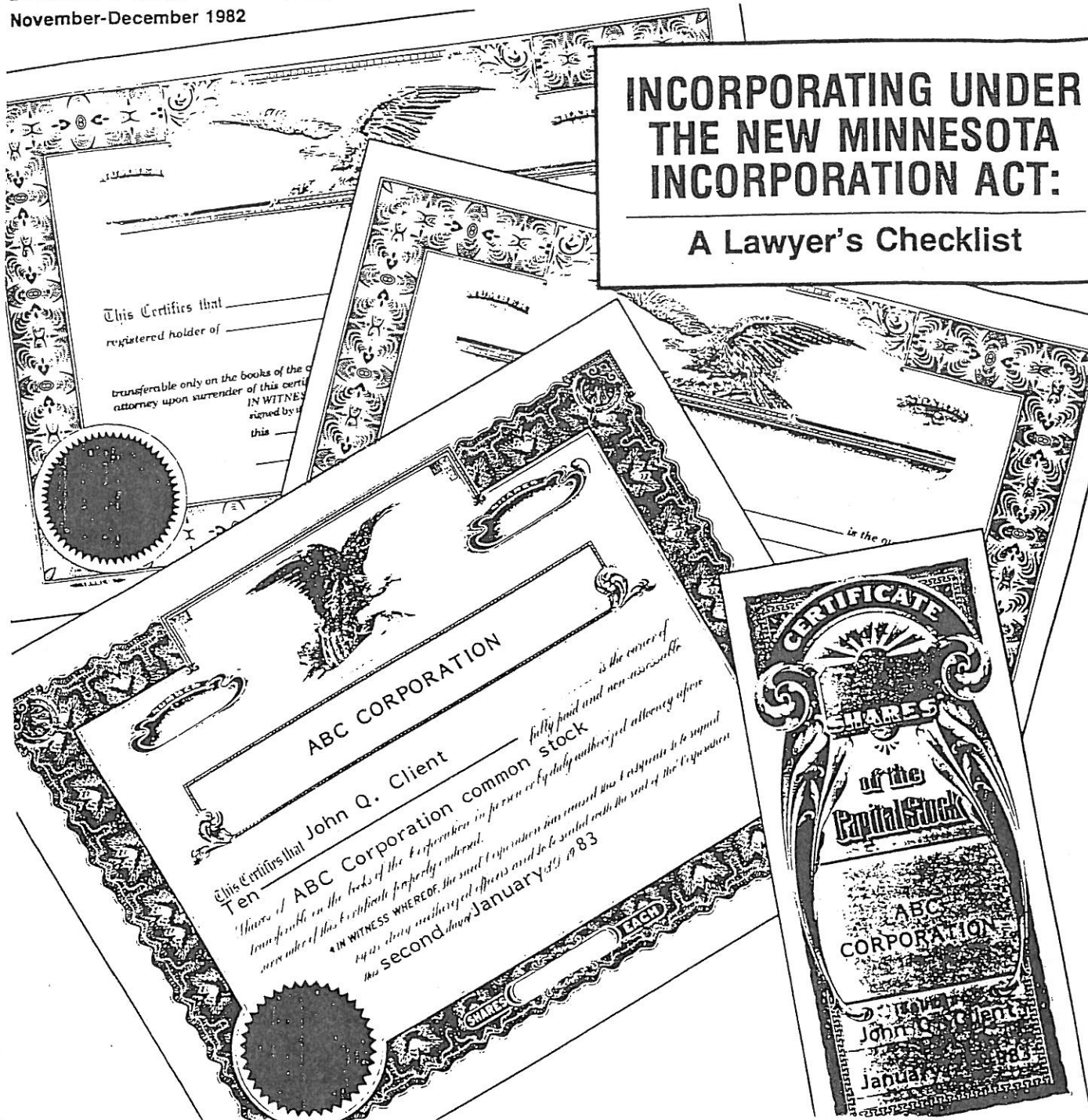
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## INCORPORATING UNDER THE NEW MINNESOTA INCORPORATION ACT:

### A Lawyer's Checklist



# THE HENNEPIN LAWYER



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November-December 1982

Editor  
This  
Issue



## INSIDE VIEW

BY WRIGHT S. WALLING

It is one of the editorial facts of life that when a member of *The Hennepin Lawyer* committee agrees to be the editor of an issue of *The Hennepin Lawyer*, he or she is, with little or no ability to prevent it, thrust upon the front page of that issue and told to impart to the brethren of the bar, vast pearls of wisdom about the articles which follow. In the years that I have been on this committee, I have yet to discern either the origin of, or the philosophy behind, this particular practice. Nevertheless, with the publication of this magazine waiting only upon my distillation of such gems, I have been forced into some reflections.

The articles which appear in this issue are self-explanatory. They reflect well, I think, the current policy of the committee in its attempt to balance practical nuts and bolts articles published to assist the practitioner with the explanatory articles designed to keep members of the bar informed as to what is happening in the legal community. This being the case, it would appear redundant to do other than refer the reader to those articles themselves.

In the course of my reflections, however, I have been struck by one repetitive note. It is perhaps not startling or mind boggling. It is perhaps not even so stunning to the bar as to be worth mentioning. Yet, in my discussions with various attorneys, I have continued to be surprised at how many practitioners seem not to be aware of it; or, reject it as either untrue or premature.

That is, that the spectrum of delivery of legal services is undergoing a revolution. It is a revolution caused by both external and internal forces and will result, if it has not already, in substantial changes in how consumers view lawyers and their services; and how lawyers view themselves and their place in society.

During the relatively short time that I have been in practice, the entire foundation of the relationship between lawyers and consumers has been shaken and crumbled. The Code of Responsibility has reflected these fluctuations and trends. The changes in the rules on advertising alone have created a climate which has only begun to be felt in society.

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# Incorporating Under the New Minnesota Incorporation Act: A Lawyers Checklist

BY RICHARD A. SALITERMAN and JEFFREY C. ROBBINS

This Article is aimed at assisting the newer practitioner in organizing small private corporations for his or her client. In most areas of corporate or commercial law, a checklist is absolutely necessary, and even in the basic incorporation of a close corporation there is no exception to the rule. As authors we have examined many checklists but, unfortunately, have not been able to find one which directly addresses the very substantial legislative changes brought about by the new Minnesota Business Incorporation Act, Minnesota Statutes Chapter 302A (hereinafter, the New Act).<sup>1</sup> Beginning January 1, 1984, most corporations, including those incorporated under Chapter 301 (hereinafter the Old Act),<sup>2</sup> will be governed by the New Act.<sup>3</sup> Currently, corporations may elect to incorporate under either the Old or the New Act,<sup>4</sup> and those corporations incorporated under the Old Act may elect governance under the New Act provisions.<sup>5</sup>

This checklist also includes recent administrative and legislative changes in the area of intellectual property, taxation, compensation and fringe benefits, and securities law. This Article, despite any implication to the contrary, is not intended to be exhaustive or authoritative, but had best be perceived as being "suggestive." Certainly each practitioner will want to develop his or her own checklist.

## I. Pre-Incorporation Considerations

### A. ETHICAL OBLIGATIONS.

1. **Conflicts of Interest.** The practitioner should remind each party to the initial incorporation undertaking of potential ethical conflicts of interest inherent in multiple representation and accordingly advise that each party obtain separate counsel. This is especially true where shareholder agreements (see *infra* § I.I.) are to be executed. If it is obvious that the attorney can adequately represent the interests of each party, the attorney may continue multiple representation after disclosing the potential conflict and obtaining the consent of all parties.<sup>6</sup>

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2. **Duty of Competence.** A lawyer owes a duty to his or her clients to help achieve the client's lawful objectives.<sup>7</sup> In furtherance of this goal, the practitioner should consider the following:

a. **The Need to Incorporate.** The attorney should insure that alternative forms of business organization, such as partnership, have been considered and that there is a firm consensus on the desire to incorporate. The client should be fully advised of the various tax, financing, and liability considerations associated with different formats of business enterprises. A preincorporation agreement might be drafted to state the parties' expectations and to define the liabilities of the promoters.<sup>8</sup>

b. **Corporate Liabilities.** The practitioner should advise all parties involved of the general legal and fiduciary duties and potential liabilities of officers and directors of a corporation.

c. **Timing the Incorporation.** Corporate counsel must insure sufficient time for drafting of all documentation and for obtaining its approval by all of the interested parties.

d. **Documentation of Incorporation.** The clients should understand that various aspects of the incorporation process will require the input of experts such as an accountant. As corporate counsel prepares documents, copies of all matters should be provided to the parties involved. Preliminary drafts should be code-dated so that the date of actual preparation is identifiable on the face of the document, and such drafts should be marked as "preliminary drafts for consideration" in order to avoid future misunderstandings.

### B. FINANCING THE CORPORATION.

Although the New Act no longer requires a minimum corporate capitalization,<sup>9</sup> the corporation must obtain capital in order to commence business. Normally, the corporate promoters will subscribe for shares in the business. Other sources of funding include:

1. **Personal Loans.** The shareholders may be willing to provide initial seed money to support corporate expenses



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The authors wish to express their appreciation to the following persons for their editorial suggestions on this piece: C.R. Morris, Professor of Law at the University of Minnesota; Stan Gove, Vice President, First National Bank of Minneapolis; Arthur Glassman, Coopers & Lybrand; and Avron Gordon, Briggs & Morgan.

The Hennepin Lawyer



## 2. External Sources of Financing.<sup>10</sup>

a. *Commercial Banks.* Perhaps the most common external source for corporate financing is the commercial bank loan. Usually, such loans are secured by corporate assets and require the personal guarantee of the majority shareholders and/or the corporation's key personnel. Often, the bank will require that the corporation maintain a compensating balance at the bank, and the loan agreement may contain covenants regarding working capital, financial statements to be provided to the bank on a regular basis, restrictions on corporation employee salaries, and restrictions on dividends.

There are various types of commercial bank loans:

i) *Direct Loans to Corporate Principals.* These loans depend upon the creditworthiness of the individual borrowers. The lending institution expects the borrower to use the proceeds to incorporate a business by personally loaning the borrowed funds to the business entity.

ii) *Commercial Loans Made Directly to the Corporation.* Such loans are usually of a short duration (i.e., 60-90 days) and are usually extended for seasonal use.

iii) *Lines of Credit to the Corporation.* If the corporation appears to be financially healthy, or if the major shareholders of the corporation have a strong net worth, the bank may establish a line of credit for the corporation. This line of credit will permit the corporation to draw funds from the bank as needed and up to a set maximum amount. The loans made are generally extended on a short-term basis and are usually secured by corporate assets, such as inventory or accounts receivable. The corporation pays interest only on those funds actually drawn.

iv) *Unsecured Term Loans.* If the corporation displays a strong debt to net worth ratio and a strong working capital position, the bank may extend such a loan.

v) *Receivable/Inventory Financing.* This is a form of secured credit and is the most common form of secured financing. With respect to receivables, the lender may advance from 50% to 80% of the face value of the domestic receivables.<sup>11</sup> The percentage that a lender will advance on inventory collateral largely will be determined by the type of collateral involved. Normally, there is a one-year agreement for such credit. Key factors in negotiating the terms of such financing include the condition the receivables are in (i.e., the time required for collection) as well as the amount of capital to be invested in corporate inventory.

vi) *Real Estate and Equipment Term Loans.* Such loans are also a form of secured indebtedness for equipment. The loan term is usually between one and five years, and the amount of the loan is generally between 60% to 80% of the value of the equipment. For realty, 75% of the

property value is often loaned. The term of loans secured by real estate are between 10 and 25 years.

vii) *Small Business Administration (SBA) Loans or SBA Guaranteed Loans.* The SBA may loan directly to the corporation if certain qualifications are met and if funds are available; or, most frequently, the SBA will guarantee a corporate loan made by another financial institution up to 90% of the amount of that loan. However, such loan guarantees under current law cannot exceed \$500,000. Usually these loans are secured by corporate assets and involve some form of personal guarantee by corporate officers or major shareholders.

b. *Savings and Loan Institutions.* Generally, these organizations may extend loans secured by real property with terms of up to 25 years. The loan amount is normally between 45% to 75% of the property's appraised value.

c. *Life Insurance Companies.* Personal loans to corporate shareholders or officers can be made by life insurance companies. The terms of such loans are intermediate or long-term.

d. *Trade Credit.* This might be considered as a form of an indirect short-term loan. Basically, a supplier of goods (i.e., an inventory supplier) may extend credit to the corporation on open account. The terms of such credit vary, and discounts by the suppliers may accompany early payment by the corporation.

e. *Leasing.* On the corporation's request, banks and private leasing corporations, as well as other financial institutions, may lease almost any type of business-related personal property (usually equipment) to the corporation. Lease terms are frequently three or more years, and leases may be open-ended or closed-ended. Normally, a smaller advance payment is required by a lessor for a lease than is required by a lender when purchasing equipment.

f. *Private Offerings of Securities.* See *infra* §I.F. (Securities Considerations).

g. *Public Offerings of Securities.* Securities of the corporation may be publicly issued to raise capital. Such offerings normally do not take place upon the initial incorporation of the business. Once the corporation distinguishes itself by its strong management team, a growth pattern higher than that of the industry generally, and a good record of earnings, it may wish to consider the public offering of debt or equity instruments.<sup>12</sup>

## C. ACCOUNTING METHODS.

1. *Selection of Fiscal Year.* Generally, a calendar year is best for small corporations as all federal and state tax procedures are generally keyed to a calendar year. The normal accounting period is twelve months, but this period can be less at the outset. By closing its taxable year prior to the expiration of the first twelve months of corporate existence, the corpo-

ration may be able to achieve some tax deferral in some circumstances. For example, it is often possible to maximize the use of lower, graduated tax rates by closing the initial year after the corporation's taxable income reaches \$100,000. Counsel should also remind corporate officers of the requirement to make estimated quarterly tax payments.

## 2. Methods of Accounting.

a. *Cash Method Accounting.* Under this computation method, all items which constitute gross income are to be included in gross income for the taxable year in which they are actually or constructively received.<sup>13</sup>

b. *Accrual Method Accounting.* Under this method, income is to be included for the taxable year when all the events have occurred which fix the right to receive such income and the amount thereof can be determined with reasonable accuracy.<sup>14</sup>

c. *Combination of Cash and Accrual Accounting.* If the corporation uses the accrual method of accounting with respect to purchases and sales, it may use the cash method in computing all other items of income and expense.<sup>15</sup>

d. *Installment Method.* For qualifying sales, the corporation will report as gain

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<sup>10</sup>Minn. Stat. §5302A.001-917 (Supp. 1981).

<sup>11</sup>Minn. Stat. §5301.01-61 (1980).

<sup>12</sup>Minn. Stat. §302A.021 (7) (1982). Chapter 300 corporations which have not elected governance of the Old Act do not automatically become governed by the New Act. *Id.* This is because Chapter 300 does not include a reservation of power to amend section as is found in the Old Act. See Minn. Stat. §301.59 (1980). See also *Dartmouth College v. Woodward*, 17 U.S. (4 Wheat.) 518, 712 (1819) (Story, J., concurring) (violation of Contract Clause of the U.S. Constitution, Art. I, §10, to force change in corporate charter when no reservation of authority to amend was included in original charter).

<sup>13</sup>Minn. Stat. §302A.021 (6) (Supp. 1981).

<sup>14</sup>Minn. Stat. §302A.021 (2) (1982). Professional corporations incorporated under both Chapter 319A and the Old Act may also make this election. The election is made by a resolution approved by shareholders holding the same proportion of voting power required to amend the corporation's Articles prior to the election. The corporation must file the resolution with the Secretary of State. If the Articles must be amended to conform to the New Act, the corporation must also file the amended Articles with the Secretary of State. If no amendment of the Articles is required to conform to the New Act, the resolution must so indicate. Minn. Stat. §302A.021 (4) (1982).

<sup>15</sup>Minnesota Code of Professional Responsibility, DR 5-105(C).

<sup>16</sup>*Id.* DRs 6-101 (A) (2); 7-101 (A) (1).

<sup>17</sup>F. O'Neal, *1 Close Corporations* §2.23 (1971).

<sup>18</sup>Cf. Minn. Stat. §301.04 (6) (1980) (\$1,000 minimum stated capital under the Old Act).

<sup>19</sup>For a good discussion of various forms of external financing, see Minnesota Continuing Legal Education, *Financing Small Businesses* 4-14 (1978). See generally W. Baughn & C. Walker, *Banker's Handbook* (1978); D. Hayes, *Bank Lending Policies, Issues and Practices* (1964).

<sup>20</sup>Lenders are hesitant to lend or are more conservative in lending on foreign accounts receivable.

<sup>21</sup>For a discussion of the merits of a public offering, see generally G. Robinson & K. Eppler, *Going Public* (1978).

<sup>22</sup>Treas. Reg. §1.446-1 (c) (1) (i).

<sup>23</sup>Treas. Reg. §1.446-1 (c) (1) (iii).

<sup>24</sup>Treas. Reg. §1.446-1 (c) (1) (iv) (a).

in a taxable year the proportion of the installment payment received in that year which the gross profit, realized or to be realized when the payment is completed, bears to the total contract price.<sup>16</sup> This method thus permits the spreading of income tax over the period during which payments of the sales price are received.

*e. Completed Contract Method.* Under this method, the corporation takes into gross income the gross contract price of each long-term contract for the taxable year in which such contract is completed.<sup>17</sup>

*f. Percentage of Completion Method.* If the corporation selects this accounting method, the portion of the gross contract price on a long-term contract which corresponds to the percentage of the entire contract which has been completed during the taxable year must be included in gross income for that taxable year.<sup>18</sup>

*g. LIFO Versus FIFO Accounting.* If the corporation is engaged in an inventory intensive business, the selection of inventory accounting will greatly affect the amount of taxable income recognized. For example, during an inflationary economy, the Last-In-First-Out (LIFO) method of accounting will be preferred to the First-In-First-Out (FIFO) method because the LIFO method will provide the corporation with a higher cost of goods, which will in turn reduce corporate profits.

#### D. TAX MATTERS.

##### 1. Federal.

*a. Employer Identification Number.* Every corporation which employs one or

more persons whose wages are either subject to the Federal Insurance Contributions Act (FICA) taxes or to the withholding of income taxes must apply for an identification number.<sup>19</sup>

*b. Transfer of Assets to the New Corporation.* Under the Internal Revenue Code, a property transferor must recognize gain or loss on the sale or other disposition of property.<sup>20</sup> Thus, if the corporation purchases assets from shareholders or third parties, the sellers will recognize gain or loss (ordinary or capital, depending upon the nature of the assets sold<sup>21</sup>), and the corporation will acquire a cost basis in the assets acquired.<sup>22</sup> However, if one or more persons transfer property to the corporation solely in exchange for stock or securities of such corporation, and if after the exchange such persons control the corporation,<sup>23</sup> then the property transferors do not recognize gain or loss on the disposition of the property.<sup>24</sup> On the other hand, the corporation will then acquire a carryover basis in the assets received as a quid pro quo for the transferor's nonrecognition of gain.<sup>25</sup>

*c. Losses on Small Business Stock.* Section 1244 of the Internal Revenue Code permits the stock of certain corporations to be designated "small business corporation stock."<sup>26</sup> On the disposition of such stock, individual shareholders<sup>27</sup> may treat losses on such stock<sup>28</sup> as ordinary, and not as capital, losses.<sup>29</sup> While the Code does not require shareholders to adopt a written plan to elect the provisions of Section 1244, as a practical matter, a written corporate resolution should

be prepared indicating that the corporation's stock is being treated as Section 1244 stock.

*d. Subchapter S Corporations.* If all the shareholders<sup>30</sup> of certain "small business corporations" so elect,<sup>31</sup> the corporation will not be taxed at the corporate level, but will have its income passed through and taxed to the shareholders pro rata as ordinary income.<sup>32</sup> No election as an S corporation need be made under Minnesota law.<sup>33</sup>

*e. Accelerated Cost Recovery (ACRS).* Under ACRS, the corporation is permitted to recover the capital cost of depreciable property over a pre-determined period that is generally shorter than the asset's useful life or the period during which it is used to produce income.<sup>34</sup>

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<sup>16</sup> IRC §453 (c).

<sup>17</sup> Treas. Reg. §1.451-3 (d). But see Tax Equity and Fiscal Responsibility Act of 1982, §229 (changes rules on cost allocations under completed contract accounting method).

<sup>18</sup> Treas. Reg. §1.451-3 (c).

<sup>19</sup> Treas. Reg. §31.6011 (b)-1 (b) (1982). The application for an identification number must be made on Form SS-4. See 2 Tax Action Coord. (RIA) 714.121-22 (1982).

<sup>20</sup> IRC §1001 (a) (1).

<sup>21</sup> See IRC §1221, 1222, 1202.

<sup>22</sup> IRC §1012.

<sup>23</sup> "Control" requires the transferors to acquire at least 80% of the total combined voting power of all voting classes and 80% of each class of non-voting stock. IRC §368 (c); Rev. Rul. 59-249, 1959-2 C.B. 115.

<sup>24</sup> IRC §351 (a). The corporation also recognizes no gain on the receipt of the assets in exchange for issuance of the stock of the corporation. IRC §1032 (a).

<sup>25</sup> IRC §362 (a).

<sup>26</sup> IRC §1244 (c) (1). To qualify as Section 1244 stock, the corporation must qualify as a "small business corporation" both at the time of issuance and of sale of the stock. Section 1244 (c) (3) (A) defines a "small business corporation" as one whose contributed capital and paid in surplus does not exceed \$1,000,000. Additionally, the stock must be issued for money or property, other than stock and securities (§1244 (c) (1) (B)), and the corporation, during its five most recent taxable years, must have derived more than 50% of its income from sources other than royalties, rents, dividends, interests, annuities, and stock transactions (§1244 (c) (1) (C)).

<sup>27</sup> Section 1244 (d) (4) expressly excludes trusts or estates from the provisions.

<sup>28</sup> Only the shareholders to whom the stock was "issued" may benefit by these provisions. IRC §1244 (a). The maximum loss in any one tax year treated as ordinary is \$50,000 for an individual and \$100,000 for spouses jointly filing a return. IRC §1244 (b).

<sup>29</sup> IRC §1244 (a).

<sup>30</sup> See IRC §1362 (a) (2). This material reflects the Subchapter S Revision Act of 1982, generally effective for taxable years beginning after December 31, 1982.

<sup>31</sup> The election must be made on Form 2553. See 4 Tax Action Coord. (RIA) 737.652 (1981).

<sup>32</sup> IRC §1366 (a). Subchapter S corporations cannot have more than 35 shareholders (§1361 (b) (1) (A)), none of whom can be nonresident aliens (§1361 (b) (1) (C)), and all of whom must be individuals (§1361 (b) (1) (B)) or certain trusts (§1361 (c) (2)). In calculating the number of shareholders for qualification as a Subchapter S corporation, husband and wife are treated as one shareholder during the time of their marriage. IRC §1361 (c) (1).

<sup>33</sup> Minn. Stat. §290.9725 (Supp. 1981).

<sup>34</sup> IRC §168 (b) (1). But see Tax Equity and Fiscal Responsibility Act of 1982, §206 (repealing scheduled future increases in cost recovery rates).



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## INCORPORATION ACT (Continued)

*f. Investment Tax Credit.* The Internal Revenue Code permits the corporation to receive a credit against its tax liability with respect to the corporation's investment in certain types of depreciable assets.<sup>35</sup>

*g. Research and Development Expenses.* The corporation may elect to treat certain research and experimental expenditures as deferred expenses to be amortized as a deduction over at least a 60-month period.<sup>36</sup> Alternatively, research expenses may be deducted in the year paid or incurred or may be charged to the corporation's capital account.<sup>37</sup>

### 2. State.

*a. Income Tax Withholding Identification Number.* Minnesota corporations with employees must withhold wages of such employees<sup>38</sup> and must have a taxpayer identification number.<sup>39</sup>

*b. Sales Tax Permit and Identification Number.* Every corporation making retail sales in Minnesota must apply for a sales tax permit and use number.<sup>40</sup> A permit must be obtained for each place of business.<sup>41</sup>

*3. Local Licenses and Taxes.* Local jurisdictions in Minnesota may place licensing or taxing restrictions upon the operation of particular businesses in the state.<sup>42</sup>

## E. COMPENSATION AND FRINGE BENEFITS.

Perhaps the most important overall goals or themes for the practitioner to address in this area are: (1) the desirability of withdrawing funds from the corporation at other than ordinary income rates; (2) the possibility of securing a tax deduction for the corporation in this process; and (3) the avoidance of an excessive accumulation of earnings and profits in the corporate treasury. Some transactions to consider are:

*1. Salaries.* The salaries of corporate officers should be set and measured as to their reasonableness for the services to be rendered. To the extent that such salaries are excessive, the corporation cannot receive a business expense deduction.<sup>43</sup>

*2. Commissions.* The corporation should set commissions and bonuses with respect to independent contractors and employees.

*3. Reimbursing Business Expenses.* The corporation should establish a schedule for reimbursable expenses, such as mileage, meals and lodging, moving expenses, and club dues. Standards for qualification should be established, and officers should be required to provide receipts documenting qualified expenses.

*4. Pension Plans.* These plans involve mandatory corporate contributions and can be funded up to \$90,000 per year starting in 1983, with indexed increases in this ceiling beginning in 1986.

*5. Profit Sharing Plans.* These plans are on a pre-determined discretionary formula. There is a 15% maximum contribution based on the gross compensation of the particular employee involved,<sup>44</sup> and certain vesting considerations also must be considered.<sup>45</sup>

*6. Individual Retirement Accounts (IRA).* A working spouse or single individual is permitted to contribute up to \$2,000 of his or her compensation to an IRA for each tax year.<sup>46</sup> Two working spouses may jointly contribute up to \$4,000 per year.<sup>47</sup> If a working spouse contributes to a nonemployed spouse's IRA, the contribution may be up to \$2,250 per year.<sup>48</sup> The amount contributed to an IRA is permitted as a deduction from gross income for that taxable year.<sup>49</sup>

*7. Non-Qualified Deferred Compensation Plans.* Under such a plan, corporate deductions for contributions made are postponed until the employee-recipient is taxed on the deferred compensation. The corporation can selectively target the plan to certain key personnel, which is an attractive feature.

*8. Incentive Stock Option Plans (ISO).* Neither the granting of nor the exercise of stock options are income to corporate employees, although such plans can create a tax preference and trigger an alternative maximum tax. If the employee retains stock acquired by an option purchase for a specified period of time, the disposition of such stock pursuant to the plan will cause taxation at capital gain rates.

*9. Non-Qualified Stock Option Plans.* The optionee must include in ordinary income at the time of the grant the fair market value of the option.

*10. Stock Ownership Participation.* A stock ownership program generally provides key employees with the right to acquire corporate stock, often at below market rates. The corporation usually reserves a right to repurchase the employee's stock when the employee terminates his or her relationship with the corporation. Such participation gives employees an equity participation in the

overall corporate undertaking and may improve employee morale.

*11. Phantom Stock and Stock Appreciation Rights.* Such programs allow employees to share in the growth of corporate stock values.

*12. Other Various Plans.* Corporate counsel should also discuss other various plans which are not taxed to the employee as income and which are also deductible on the corporation's tax return. These include:

*a. Medical and Dental Plans.*

*b. Group Legal Services.*

*c. Group-Term Life Insurance.* The corporation may wish to fund a life insurance program either for all employees or only for key employees as a mechanism to finance a corporate buy-out on account of the death of a key employee — major shareholder. The Internal Revenue Code presently permits employees to exclude from gross income the cost of at least \$50,000 of employer-provided life insurance.<sup>50</sup> Beginning in 1984, however, such life insurance programs will become

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<sup>35</sup>IRC §48(a). But see Tax Equity and Fiscal Responsibility Act of 1982, §205 (b) (limiting the credit to \$25,000 plus 85% of the corporation's tax liability in excess of \$25,000).

<sup>36</sup>IRC §174 (b) (1).

<sup>37</sup>Treas. Reg. §1.174-1.

<sup>38</sup>Minn. Stat. §290.92 (20) (1) (Supp. 1981).

<sup>39</sup>Minn. Stat. §290.92 (24) (Supp. 1981). The application should be made on Form MBA. See [Minn.] St. Tax. Rpts. (CCH) ¶ 61-425, at 6261 (1981). There is no fee for submitting the application.

<sup>40</sup>Minn. Stat. §297A.21 (1) (1980).

<sup>41</sup>Minn. Stat. §297A.04 (1980). The application is made on Form MBA. See *supra* note 114. There is a \$1.00 fee for submission of an application for each place of business. Reg. Tax S & U 202 (F), [Minn.] St. Tax. Rpts. (CCH) ¶ 60-607, at 6235 (1980).

<sup>42</sup>For example, Minn. Stat. §88.649 requires Christmas tree dealers who store more than 1,000 trees to pay a \$200 license fee. See [Minn.] St. Tax. Rpts. (CCH) ¶ 30-100 for a comprehensive review of local licenses and taxes authorized by state statutes.

<sup>43</sup>Treas. Reg. §1.162-7 (b) (1).

<sup>44</sup>IRC §404 (a) (3) (A).

<sup>45</sup>IRC §411 (a).

<sup>46</sup>IRC §219 (b) (1).

<sup>47</sup>IRC §219 (f) (2).

<sup>48</sup>IRC §219 (c) (2).

<sup>49</sup>IRC §219 (a).

<sup>50</sup>IRC §79 (a) (1).

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## INCORPORATION ACT (Continued)

subject to new provisions which prohibit discrimination in favor of key employees.<sup>51</sup>

d. *Accident, Health, and Disability Insurance.*

### F. SECURITIES CONSIDERATIONS.

The main rule under both Minnesota blue-sky and federal securities law is that all securities<sup>52</sup> must be registered unless a specific exemption is obtained under both state and federal law. It is especially important for the inexperienced practitioner to obtain expert input in order to avoid hidden and substantial exposures in this area.

#### 1. Minnesota Blue-Sky Exemptions.

Among the transactions which are exempted from the Minnesota blue-sky registration requirements are:

a. *Initial Offerings.* One of the most useful transactional exemptions concerns the exemption for initial offerings.<sup>53</sup> For qualification, the corporation must have its principal offices in Minnesota, the aggregate number of holders of all of the corporation's securities, all of whom purchased for investment purposes, cannot exceed ten,<sup>54</sup> and all sales must be con-

summated within 30 days after the commencement of business by the corporation. The corporation also cannot publish or circulate any advertising in connection with the sale.

b. *Isolated Sales Transactions.* Up to five sales of securities of the same corporation may be made by the corporation during any period of twelve consecutive months, provided that the corporation reasonably believes that all buyers are purchasing for investment, and provided that the securities are not advertised for sale to the general public.<sup>55</sup>

c. *Limited Distributions.*<sup>56</sup> Minnesota law also provides an exemption for 25 sales by the corporation during any period of twelve consecutive months, whether or not any of the purchasers are then present in the State of Minnesota.<sup>57</sup> Among other requirements, the purchasers must purchase for investment only, and a statement concerning the distribution must be submitted to the Securities Commissioner ten days prior to any sale pursuant to the exemption.

#### 2. Federal Exemptions.

a. *Exempted Securities.* The Securities Act of 1933 exempts certain classes of securities from the registration, but not the antifraud, requirements of the Act. For example, registration is not required for an issue which is offered and sold only to persons resident within a single state, if the issuing corporation is incorporated by and does business within such state.<sup>58</sup>

b. *Transactional Exemptions.* The Securities Act of 1933 also exempts certain transactions from the registration, but not the antifraud, requirements of the Act. Among these exemptions are:

i. *Non-Public Offering Exemption.* Transactions by a corporate issuer not involving a public offering are exempted from registration.<sup>59</sup> The caselaw construing this exemption generally requires that an offering be made to 25 or fewer offerees, that the offerees be sophisticated investors with access to all information normally available in a registration statement, that the offering not be advertised publicly, and that the securities sold are restricted as to their resale.<sup>60</sup>

ii. *Regulation D Exemptions.* The Securities and Exchange Commission has promulgated a series of regulations exempting certain limited offers and sales of securities. Compliance with one of these exemptions provides a "safe-harbor" mechanism for avoiding registration of an offering.

a) *Rule 504.*<sup>61</sup> For offerings made over a 12-month period not exceeding \$500,000, corporations which are not reporting or investment companies may sell securities to an unlimited number of persons, regardless of their sophistication as investors. No specific information must be disseminated to purchasers in order to qualify under this Rule. If the offering is registered under a state blue-sky law which requires the delivery of a

disclosure statement to prospective purchasers prior to sale, the issuing corporation may engage in general solicitation and advertising in that state, and the securities need not be limited as to resale.

b) *Rule 505.*<sup>62</sup> For offerings made over a 12-month period not exceeding \$5,000,000, most corporate issuers may sell securities to 35 purchasers<sup>63</sup> regardless of their sophistication as investors. However, unless the offering is made only to "accredited investors,"<sup>64</sup> the corporation will have to provide certain information to all investors before they purchase<sup>65</sup> and will have to respond to questions concerning the offering made by prospective investors.<sup>66</sup> General solicitation on page 20

<sup>51</sup>Tax Equity and Fiscal Responsibility Act of 1982, §244 (a) (adding §79 (d) (1) to the Internal Revenue Code). Under this statutory change, discriminatory programs prevent key employees from relying on §79 (a) (1) to exclude the cost of \$50,000 of life insurance from gross income. Cf. IRC §105 (b) (antidiscrimination provisions with respect to self-insured medical expense reimbursement plans).

<sup>52</sup>The term "securities" is broadly defined under both federal and state law. See e.g., §2 (1) of the Securities Act, 15 U.S.C. §77b (1) (1976); SEC v. W.J. Howe Co., 328 U.S. 293, 298-99 (investment concerning citrus grove development held a "security"); Minn. Stat. §80A.14 (18) (Supp. 1981); State v. Coin Wholesalers, Inc., 311 Minn. 346, 355, 250 N.W.2d 583, 588 (1976) (stating that Minnesota test is broader than federal standard set forth in *Howey*).

<sup>53</sup>Minn. Stat. §80A.15 (2) (k) (Supp. 1981).

<sup>54</sup>However, certain large investors, such as banks, are not included in calculating the number of purchasers. See Minn. Stat. §80A.15 (2) (g) (Supp. 1981).

<sup>55</sup>Minn. Stat. §80A.15 (2) (a) (Supp. 1981). Sales to spouses and certain other related investors are not included in calculating the five sales if such sales are made within forty-eight hours of a sale to another purchaser. S Div Rule 2115 (b) (1) (aa) (1981).

<sup>56</sup>However, 35 sales may be made under this exemption if the offering is made in compliance with SEC Rule 146, 17 C.F.R. §230.146 (1981) (now superseded by SEC Rule 506, 17 C.F.R. §230.506 (1982)). S Div Rule 2118 (b) (1981). Also, sales to spouses of purchasers are not counted. S Div Rule 2118 (a) (1) (aa) (1981).

<sup>57</sup>Minn. Stat. §80A.15 (2) (h) (Supp. 1981).

<sup>58</sup>Securities Act of 1933, §3 (a) (11), 15 U.S.C. §77c(a) (11) (1976). This particular "intrastate" offering exemption is also the subject of SEC Rule 147, 17 C.F.R. §230.147 (1981). Commentators in the area of securities law have expressed reservations about this Rule's effectiveness. See e.g., Alberg & Lybecker, New SEC Rules 146 and 147: The Nonpublic and Intrastate Offering Exemptions from Registration for the Sale of Securities, 74 Colum. L. Rev. 622, 653-54 (1974).

<sup>59</sup>Securities Act of 1933, §4(2), 15 U.S.C. §77d(2) (1976).

<sup>60</sup>See e.g., SEC v. Ralston Purina Co., 346 U.S. 119, 125-27 (1953); *Doran v. Petroleum Corp.*, 545 F.2d 893, 900-05 (5th Cir. 1977).

<sup>61</sup>17 C.F.R. §230.504 (1982).

<sup>62</sup>17 C.F.R. §230.505 (1982).

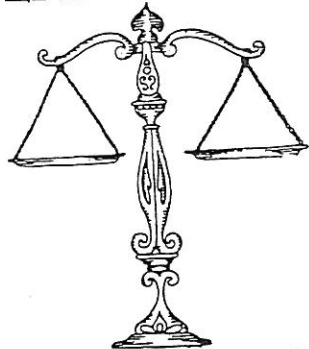
<sup>63</sup>In calculating the number of purchasers, certain "accredited investors," such as banks or individuals with a net worth in excess of \$1,000,000, and spouses of purchasers are excluded in determining the 35 purchasers permitted. SEC Rule 501 (e), 17 C.F.R. §230.501 (e) (1982).

<sup>64</sup>See *supra* note 63.

<sup>65</sup>If the issuer is not a reporting company, it will have to provide to investors virtually the same information as required by Part I of Form S-18. SEC Rule 502 (b) (2) (i) (A), 17 C.F.R. §230.502 (b) (2) (i) (A) (1982). If the issuer is a reporting company, the informational requirements are less stringent. SEC Rule 502 (b) (2) (ii), 17 C.F.R. §230.502 (b) (2) (ii) (1982).

<sup>66</sup>SEC Rule 502 (b) (2) (iv) - (v), 17 C.F.R. §230.502 (b) (2) (iv) - (v) (1982).

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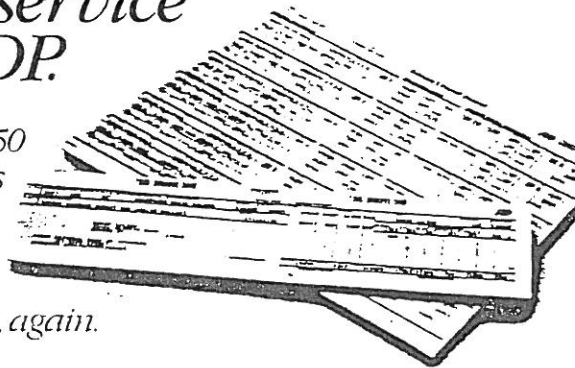
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## INCORPORATION ACT (Continued)

tion for purchasers is not permitted under this Rule, and the resale of securities sold under this Rule is restricted.

c) Rule 506.<sup>67</sup> This Rule, which replaces Rule 146, specifies no limit on the size of a permissible offering. Any corporate issuer may sell securities to 35 purchasers<sup>68</sup> who may either be "accredited investors" or purchasers who, alone or with a "purchaser representative,"<sup>69</sup> can assess the risks of investing in the corporation's securities. Securities sold under this Rule are restricted as to their resale, and the corporation cannot engage in general solicitation of prospective investors. As under Rule 505, non-accredited investors must receive certain information before purchasing<sup>70</sup> and must receive the right to question the issuing corporation concerning the offering.

iii) Regulation A Exemptions.<sup>71</sup> For certain securities, the corporation may issue up to \$1,500,000 of securities over a 12-month period. Under this Rule, the corporation must file an offering statement at least ten days in advance of a sale pursuant to this Rule, and a copy of the offering circular (a part of the offering statement) must be given to prospective purchasers concurrently with or before making an offer to sell such securities.

## G. Intellectual Property Matters.

### 1. Corporate Name.

a. *Reservation of Name.* After the corporation has selected a name, corporate counsel should make a telephone inquiry to the Secretary of State's office to insure that the selected name is available. Because the telephone inquiry does not guarantee the availability of a corporate name, the New Act permits persons intending to incorporate in Minnesota to file a request with the Secretary of State to reserve a corporate name. A reservation is exclusive for 12 months and may be renewed.<sup>72</sup> Consideration also should be given to the determination of the availability of, and reservation of, the desired name in other states.

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<sup>67</sup> 17 C.F.R. §230.506 (1982).

<sup>68</sup> The same rules on calculating the number of purchasers under Rule 505 also apply to Rule 506. See *supra* note 63.

<sup>69</sup> A "purchaser representative" is generally an individual not associated with the corporate issuer who has attained a certain degree of sophistication with respect to investment decisions. SEC Rule 502(h), 17 C.F.R. §230.502 (h) (1982).

<sup>70</sup> If the offering exceeds \$5,000,000, and the corporation is a non-reporting company, the corporation generally must provide that information which would normally be required by Form 1 of a registration statement. SEC Rule 502(b)(2)(ii)(B), 17 C.F.R. §230.502(b)(2)(ii)(B) (1982). The information requirements for offerings of less than \$5,000,000 by non-reporting companies, and for all offerings by reporting companies, are governed by the same rules as apply under the Rule 505 exemption. See *supra* note 65.

<sup>71</sup> SEC Rules 251-64, 17 C.F.R. §230.251-64 (1981).  
<sup>72</sup> Minn. Stat. §302A.117(2) (Supp. 1981). Under the Old Act, the right to reserve a corporate name was restricted to persons intending to incorporate within a 12 month period. Minn. Stat. §301.05(3) (1980).

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b. *Assumed Names.* Minnesota law requires all persons to register with the Secretary of State the true name of a corporation doing business under a commercially assumed name.<sup>73</sup>

c. *Authorization to Qualify as a Foreign Corporation.* If the Minnesota corporation wishes to transact business in other jurisdictions, it will have need to comply with that state's rules on establishing an agent for service of process and registering the corporation's trade names.

2. *Trademark Considerations.* Even assuming the availability of a corporate name with the Minnesota Secretary of State, such availability is no insulation from potential exposure to lawsuits for trademark infringement and unfair competition. Thus, where any substantial amount of capital is involved in a corporation, it is often highly advisable to conduct an independent trademark search through a qualified search service in New York, Boston, or Washington, D.C.

a. *Federal Protection.* The corporation should consider an application for trademark registration with the U.S. Patent and Trademark Office.<sup>74</sup>

b. *State Protection.* The corporation should also consider Minnesota state trademark registration<sup>75</sup> and possible trademark registration in other states where the corporation intends to do business.

3. *Copyright Considerations.* Corporate counsel should investigate whether to copyright materials developed by or for the corporation and should insure that any publications involving copyrighted matter contain the appropriate notice.<sup>76</sup>

4. *Patent Considerations.* An investigation of the prospects for obtaining either a design<sup>77</sup> or utility patent<sup>78</sup> with respect to objects that may be the subject of the corporation's undertaking for manufacture or distribution should be considered. It may be advisable to conduct a full patent search and to retain expert patent counsel. It should be noted that in most European and other nations, patent rights are immediately lost if an object is sold to the public without prior application. In America any patent rights are lost one year after public disclosure.

5. *Trade Secret Protection.* Corporate trade secrets should be appropriately identified and protected. Non-disclosure agreements should be executed by all employees having access to confidential matters.<sup>79</sup>

#### H. DISTRIBUTION AND MARKETING.

1. *Compliance with Minnesota Franchise Act.* Minnesota law prohibits persons from offering or selling any non-exempt franchise<sup>80</sup> unless a registration statement has been filed with the Securities Commissioner.<sup>81</sup> Franchisors who violate the Act can be liable to franchisees for

damages, for rescission, and for attorneys' fees.<sup>82</sup>

2. *Antitrust Law Compliance.* The Sherman Act<sup>83</sup> prohibits competing entities from engaging in horizontal price-fixing<sup>84</sup> or territorial market allocation.<sup>85</sup> However, a manufacturer is permitted unilaterally to impose non-price vertical restraints on its distributors in order to effectuate a marketing policy.<sup>86</sup>

3. *Consumer Disclosure Laws.* Depending upon the business engaged in by the corporation, it may have to comply with various consumer disclosure regulations on both the federal<sup>87</sup> and the Minnesota state level.<sup>88</sup>

#### I. SHAREHOLDER AGREEMENTS<sup>89</sup>.

The New Act specifically authorizes the shareholders of the corporation to enter into an arrangement concerning the management and control of corporate

*continued on page 23*

<sup>73</sup>Minn. Stat. §333.01 requires that a certificate be filed with the Secretary of State by a duly authorized corporate officer stating the name under which a corporation conducts its business, the true name of the corporation, and the corporation's address. The certificate must also be published in a qualified newspaper for two successive issues in the county where the corporation's principal or registered office is located. There is a \$2.00 fee for filing the certificate. Minn. Stat. §333.055 (3) (a) (1980).

<sup>74</sup>See 15 U.S.C. §1051 (1976) (Lanham Trade-Mark Act).

<sup>75</sup>See Minn. Stat. §333.20 (1980).

<sup>76</sup>See 17 U.S.C. §401 (b) (1976) (form of notice to appear in copyrighted materials).

<sup>77</sup>See 35 U.S.C. §171 (1976) (patents for designs).

<sup>78</sup>See 35 U.S.C. §101 (1976) (patents for new inventions).

<sup>79</sup>Minnesota has enacted the Uniform Trade Secrets Act, which permits the corporation to enjoin persons from disclosing trade secrets and allows the recovery of damages and attorneys' fees for the misappropriation of confidential matters. Minn. Stat. §325C.01-08 (1980).

<sup>80</sup>A "franchise" includes a contract by which a franchisee is granted the right to engage in the business of offering or distributing goods or services using the franchisor's trade name, trademark, or other commercial symbol. Also a fee, direct or indirect, is involved and a "community of interest" must be present. Minn. Stat. §80C.01 (4) (Supp. 1981).

<sup>81</sup>Minn. Stat. §80C.02 (1980).

<sup>82</sup>Minn. Stat. §80C.17 (1980).

<sup>83</sup>The Sherman Act §1, 15 U.S.C. §1 (1976), declares illegal "every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce."

<sup>84</sup>*U.S. v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 218 (1940).

<sup>85</sup>*U.S. v. Topco Assoc.*, 405 U.S. 596, 608 (1972).

<sup>86</sup>*Continental T.V. Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36, 57-59 (1977). But see *Battle v. Lubrizol Corp.*, 673 F.2d 954, 969-90 (8th Cir. 1982) (Sherman Act §1 violation where evidence demonstrated a manufacturer's termination of a dealership in response to a second dealer's price-related complaints).

<sup>87</sup>For example, the federal Truth-in-Lending Act, 15 U.S.C. §§1601-93r (1976), will govern the disclosure required in connection with certain credit transactions.

<sup>88</sup>Minnesota corporations and others doing business in the state are subject to the Uniform Deceptive Trade Practices Act. Minn. Stat. §325D.43-48 (1980). This Act prohibits manufacturers and distributors of goods from utilizing deceptive representations in selling their products.

<sup>89</sup>For an example of shareholder agreement forms, see F. O'Neal, 2 *Close Corporations*, §510.32-42 (1971).

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**INCORPORATION ACT (Continued)**  
affairs.<sup>90</sup> A shareholder agreement may concern any of the following matters:

#### 1. Stock Transfers.

*a. Inter Vivos Transfers.* Shareholders in a close corporation may wish to restrict the transfer of their shares to only existing shareholders or to persons approved by all the shareholders. An agreement may provide that before a shareholder can offer shares to third parties, such shares first must be offered to either the corporation or to the other shareholders.

*b. Transfers upon the Death of Shareholders.* Generally, the surviving relatives of a close corporation shareholder will not be interested in participating in corporate matters. Thus, the shareholders may enter into an agreement providing that upon the death of a shareholder, his or her shares will be purchased by the corporation or the other shareholders. The parties may agree to acquire life insurance sufficient to finance the acquisition of a decedent's shares upon his or her death.

*c. Other Transfers.* The shareholder contract should address the effect of the personal bankruptcy of a shareholder and should also consider the steps to be taken in case creditors attach or levy execution of a judgment upon a shareholder's stock.

*d. Restrictive Legend.* Under the terms of the Uniform Commercial Code as enacted in Minnesota, a restriction on the transfer of shares of the corporation is invalid to most parties unless a statement is placed on the stock certificates indicating that such shares are subject to a transfer restriction.<sup>91</sup>

**2. Corporate Control and Voting Agreements.** The shareholders in a close corporation may enter into an agreement concerning control of the corporation, including the election of Directors, the designation of officers, the employment of certain individuals, or the arbitration of disputes among the parties. Alternatively, the New Act permits the shareholders to enter into a voting agreement concerning any facet of corporate operations.

**3. Employment and Fringe Benefits.** The shareholders of the close corporation may enter into an agreement concerning their employment by the corporation, their salaries, and the benefits each is to receive, including stock options.

**4. Loans and Financial Activities.** The shareholders may agree among themselves to make loans to or accept loans from the corporation.

**5. Corporate Purposes.** The shareholders may enter into an agreement not to be engaged, employed, concerned, or financially interested, directly or indirectly, in the same or similar business as that then conducted by the corporation, or in any manner to compete with the corporation. Conversely, the shareholders may agree to limit the business activities of the corporation so that

its activities do not conflict with the private interests of the shareholders.

**6. Buy-Out Arrangements.** The shareholders may agree to provide for a buy-out if one shareholder desires dissolution of the corporation. For example, such an agreement might provide that the dissenting shareholder present an offer to sell his or her shares to the remaining shareholder for a stated consideration and by a certain date. The remaining shareholder can then be given a certain number of days to elect whether to accept the offer to purchase the dissenting shareholder's shares on the terms presented. The agreement also can provide that if the remaining shareholder does not so elect, the dissenting shareholder will be bound to purchase the remaining shareholder's shares according to the terms of the offer, and the remaining shareholder will be obligated to sell his or her shares. If the agreement provides that the corporation shall purchase the shares of a dissenting shareholder, the agreement should set out some procedure for determining the value of such shares. For example, the parties may agree to arbitrate the value of the shares, or the agreement may set a price for the repurchase of shares, either fixing the price or stating some objective criteria upon which the price can be determined.

#### J. ADDITIONAL PRE-INCORPORATION CONSIDERATIONS.

**1. Compliance With Bulk Transfer Laws.** Unless excepted<sup>92</sup> by the terms of the Uniform Commercial Code as enacted in Minnesota, any transfers in bulk not in the ordinary course of business of a major part of the materials, supplies, merchandise, or other inventory of an enterprise whose principal business is the sale of merchandise from stock<sup>93</sup> are ineffective against creditors of the transferor unless the transferee gives notice of the transfer to such creditors at least ten days before taking possession of or paying for the goods.<sup>94</sup> However, creditors must bring an action to set aside the transfer within six months after the date on which the transferee took possession of the goods.<sup>95</sup> Most transfers of property to the new corporation will be exempt from compliance with the bulk transfer laws as long as the corporation agrees to assume any outstanding liabilities on such property.

#### 2. Insurance.

*a. Workers' Compensation Insurance.* All non-exempt employers in Minnesota must either carry workers' compensation insurance or obtain a written order from

*continued on page 24*

<sup>90</sup>Minn. Stat. §302A.457 (Supp. 1981).

<sup>91</sup>Minn. Stat. §336.8-204 (a) (1980).

<sup>92</sup>Minn. Stat. §336.6-103 (1980).

<sup>93</sup>Minn. Stat. §336.6-102 (3) (1980). Securities brokers have been held not to be engaged in the sale of merchandise from stock. *In re Weiss Securities*, 605 F.2d 590, 597 (2d Cir. 1978).

<sup>94</sup>Minn. Stat. §336.6-105 (1980).

<sup>95</sup>Minn. Stat. §336.6-111 (1980).



## INCORPORATION ACT (Continued)

the Commissioner of Insurance permitting the employer to self-insure its liability.<sup>96</sup>

b. *Unemployment Insurance.* All non-exempt employers in Minnesota are liable for contributions to the state unemployment insurance fund.<sup>97</sup>

c. *Property and Liability Insurance.* The corporation will probably want to obtain insurance covering both fire and tornado damage to real property. Insurance covering corporate vehicles and protecting other assets from damage or theft should be obtained. Finally, the corporation may consider insuring against non-work related liability for accidents.

d. *Directors' and Officers' Insurance.* Policies are available to indemnify directors and officers for losses sustained in the defense of good faith actions taken in their corporate roles. The New Act permits, and in certain circumstances may mandate, indemnification by the corporation.<sup>98</sup>

## II. INCORPORATING THE BUSINESS.

### A. ARTICLES OF INCORPORATION.

#### 1. Required Provisions.<sup>99</sup>

a. *The Name of the Corporation.*<sup>100</sup> The Articles must include the true name of the corporation and not its commercially assumed name.

b. *The Address of the Corporation's Registered Office.*<sup>101</sup> The corporation's registered office is a location in Minnesota where parties may serve process on the corporation. Generally, the registered office is the corporation's principal place of business, executive office, or office of general counsel in Minnesota, although there is no specific location mandated.<sup>102</sup>

c. *The Aggregate Number of Shares that the Corporation is Authorized to Issue.*<sup>103</sup> The Articles may provide that the corporation is authorized to issue any number of shares or any number of classes of shares.

d. *The Name and Address of Each Incorporator.*<sup>104</sup> The incorporator or incor-

porators need not be shareholders and are commonly employees of the corporation's general counsel.

#### 2. Statutorily Imposed Presumptions That Can Be Modified Only in The Articles.

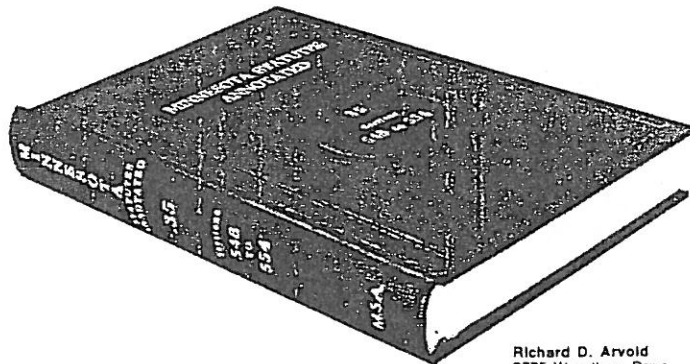
The following presumptions can be modified only in the Articles by adding an additional provision stating the change desired.

a. *Business Purpose.* Unless otherwise provided in the Articles, the corporation will have general business purposes.<sup>105</sup> The advantage to a corporation of a general business purpose presumption is that the corporation may lawfully enter into almost any type of business desired. However, the corporation cannot enter into certain regulated industries, such as banking or insurance, under the New Act. Shareholders also may wish to prevent the corporation from engaging in certain enterprises, such as a business which directly competes with the interests of a major shareholder. In this case, the Articles may include or exclude certain corporate objectives. Alternatively, the shareholders may enter into a voting or control agreement (*see supra* §I.I.2.) to limit the corporation's business activities.

b. *Corporate Duration.* Unless the Articles otherwise state, the New Act pro-

*continued on page 25*

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<sup>96</sup>Minn. Stat. §176.181 (2) (1) (1980). In general, all non-governmental employers must carry workers' compensation. *See* Minn. Stat. §176.021 (1) (1980).  
<sup>97</sup>Minn. Stat. §268.06 (1) (1) (1980).

<sup>98</sup>*See infra* text accompanying notes 183-85.

<sup>99</sup>The Old Act formerly required the corporation to publish a notice of incorporation in a qualified legal newspaper in the county where the registered office was located. Minn. Stat. §301.06 (1980). This requirement was repealed by the Legislature effective July 1, 1982. 1982 Minn. Laws, Ch. 496, §11. The Old Act also required the Articles to indicate the corporation's stated capital, the minimum amount of which was \$1,000.00. Minn. Stat. §301.04 (6) (1980). The New Act eliminates this requirement. *See* Minn. Stat. Ann. §302A.401, Reporter's Notes, at 109 (West Supp. 1982). Finally, the Old Act required the Articles to name the first Board of Directors. Minn. Stat. §301.04 (7) (1980). The New Act has no such requirement.

<sup>100</sup>Minn. Stat. §302A.111 (1) (a) (Supp. 1981). For the rules concerning a proper corporate name, *see* Minn. Stat. §302A.115 (Supp. 1981). The name is also required by the Old Act. Minn. Stat. §301.04 (1980).

<sup>101</sup>Minn. Stat. §302A.111 (1) (b) (Supp. 1981). Additionally, the Articles may name a registered agent for service of process on the corporation. Minn. Stat. §302A.111 (1) (b) (Supp. 1981). The registered agent can be a natural person residing in Minnesota, a Minnesota corporation, or a foreign corporation duly authorized to conduct business in Minnesota. Minn. Stat. §302A.121 (2) (Supp. 1981).

<sup>102</sup>The Old Act requires both the location and the post office address of the registered office. Minn. Stat. §301.04 (3) (1980).

<sup>103</sup>Minn. Stat. §302A.111 (1) (c) (Supp. 1981). This is also required by the Old Act. Minn. Stat. §301.04 (4) (1980).

<sup>104</sup>Minn. Stat. §302A.111 (1) (d) (Supp. 1981). The incorporators must be natural persons. Minn. Stat. §302A.105 (Supp. 1981). This is also required by the Old Act. Minn. Stat. §301.04 (8) (1980).

<sup>105</sup>Minn. Stat. §302A.111 (2) (a) (Supp. 1981). The Old Act required a statement of business purpose, even if general in nature. Minn. Stat. §301.04 (1) (1980).



## INCORPORATION ACT (Continued)

vides that a corporation has perpetual existence.<sup>106</sup> Generally, a corporation will want perpetual existence so that it may continue its business over an extended period of time. However, if the corporation is formed as a joint venture with limited objectives, the shareholders may wish to set a limit in the Articles on the duration of the corporation's existence.

*c. Corporate Powers.* The New Act gives corporations much flexibility by legitimizing broad powers.<sup>107</sup> Limitations on these powers must be made in the Articles.

*d. Power to Alter Bylaws.* Absent a contrary Article provision, the New Act provides that the Board of Directors generally has the authority to amend Bylaws.<sup>108</sup> The New Act also requires an Article provision to permit amendments by the Board fixing the quorum for shareholders' meetings, fixing procedures for removal of Directors or filling Director vacancies, or fixing Director classifications, qualifications, office terms or number, except that the Board may alter the Bylaws to increase the number of Directors.<sup>109</sup>

*e. Amendment of Articles.* Absent a provision in the Articles to the contrary, amendments either must be supported by the affirmative vote of a majority of Directors present at a meeting or submitted by shareholders holding 3% of the corporation's voting power.<sup>110</sup> Amendments

generally must be approved by the shareholders holding a majority of the voting power present and entitled to vote at a shareholders' meeting.<sup>111</sup>

*f. Cumulative Voting.* The New Act requires cumulative voting for Directors absent a provision in the Articles to the contrary.<sup>112</sup> Cumulative voting permits shareholders to distribute their total voting power for Directors in whatever manner they choose. Under a cumulative voting system, it is possible for minority shareholders to elect a Director when such shareholders would be unable to do so under a traditional voting system.

*g. Board Action.* Unless the Articles state otherwise, board action generally is permitted by the affirmative vote of a majority of Directors present at a meeting.<sup>113</sup> The shareholders of the corporation may wish to provide that Board action must be taken by some higher proportion of votes when the action is one having broad implications for the future of the corporation. Minority shareholders may want the Articles to provide for unanimous Board approval as a veto measure over corporate decisionmaking.

*h. Written Action of the Board.* The New Act requires all Directors to sign the corporate resolution if it is passed without a meeting, unless the Articles modify this requirement.<sup>114</sup>

*i. Board Authority to Issue Securities and Options.* The Board must authorize the issuance of securities or the rights to purchase securities unless the Articles

otherwise provide.<sup>115</sup>

*j. Shares of Stock.* Absent contrary Article provisions, the New Act provides that all common shares are entitled to vote,<sup>116</sup> that they are of one class and series,<sup>117</sup> that they generally have equal rights and preferences,<sup>118</sup> and that they have a par value of one cent for purposes of corporation capitalization tax statutes.<sup>119</sup> A "class" of stock consists of all of the corporation's shares which share the same voting rights, rights to dividends, liquidation preferences, and other such matters. The one cent par value presumption under the New Act may prevent the corporation from paying an excessive tax to do business in other jurisdictions which highly tax corporations having no

continued on page 26

<sup>106</sup>Minn. Stat. §302A.111 (2) (b) (Supp. 1981). The Old Act required a statement of corporate duration. Minn. Stat. §301.04 (2) (1980).

<sup>107</sup>Minn. Stat. §302A.161 (Supp. 1981). The specifically authorized powers under the Old Act are more limited in scope. Minn. Stat. §301.09 (1980). For example, Articles under the Old Act had to expressly state the corporation's authority to hold shares and securities of other corporations. Minn. Stat. §301.10 (1980). This power is presumed under the New Act, absent Article provisions to the contrary. Minn. Stat. §302A.161 (6) (Supp. 1981).

<sup>108</sup>Minn. Stat. §302A.161 (2) (Supp. 1981). The Old Act presumed that the power to amend Bylaws was held by the shareholders. Minn. Stat. §301.24 (1980).

<sup>109</sup>The Old Act's presumptions are less restrictive in that Directors may alter Bylaws fixing shareholder quorums or establishing procedures for Director removal or replacement without specific Article authority. Minn. Stat. §301.24 (1980).

<sup>110</sup>Minn. Stat. §302A.135 (2) (1982).

<sup>111</sup>Minn. Stat. §302A.135 (4) (1982). Cf. Minn. Stat. §301.37 (2) (a) (1980) (2/3 majority required).

<sup>112</sup>Minn. Stat. §302A.215 (Supp. 1981). This presumption is the same as found under the Old Act. Minn. Stat. §301.26 (3) (1980).

<sup>113</sup>Minn. Stat. §302A.237 (Supp. 1981). This is similar to the Old Act's presumption. Minn. Stat. §301.28 (4) (6) (1980).

<sup>114</sup>Minn. Stat. §302A.239 (1) (Supp. 1981). If the Articles permit, written action may be taken by the number of Directors required to take the same action at a meeting at which all Directors were present. *Id.* The Old Act has no authority permitting less than unanimous written consent to action. See Minn. Stat. §301.28 (4) (7) (1980).

<sup>115</sup>Minn. Stat. §302A.401 (1) (Supp. 1981). The Old Act did not make such a presumption. Minn. Stat. §301.14 (6) (1980) ("corporation" issues stock warrants).

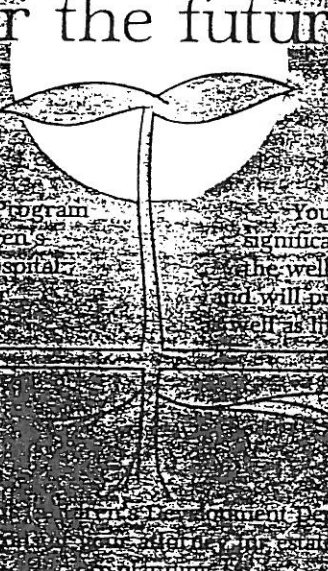
<sup>116</sup>Minn. Stat. §302A.401 (2) (b) (1982). Cf. Minn. Stat. §301.14 (1) (1980) (Old Act requires express statement in Articles or Article authorization for Board action).

<sup>117</sup>Minn. Stat. §302A.401 (2) (a) (Supp. 1981). The purpose for this presumption is to protect minority shareholders' preemptive rights under Minn. Stat. §302A.413, see *infra* note 122 and accompanying text. Absent a specific Article provision to the contrary, such preemptive rights cannot be defeated by issuance of different classes or series of stock. See Minn. Stat. Ann. §302A.401, Reporter's Notes, at 108 (West Supp. 1982).

<sup>118</sup>Minn. Stat. §302A.401 (2) (b) (Supp. 1981). The Board has the authority to set the rights and preferences of stock. Absent Board action and Article provisions to the contrary, rights and preferences are presumed equal. *Id.* Cf. Minn. Stat. §301.14 (1) (1980) (Board must be authorized by Articles to set rights and preferences of stock).

<sup>119</sup>Minn. Stat. §302A.401 (2) (c) (Supp. 1981). The New Act does not rely on the par value concept, see Minn. Stat. Ann. §302A.401 (2) (c), Reporter's Notes, at 109 (West Supp. 1982), as did the Old Act. See Minn. Stat. §301.14 (2) (1980).

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## INCORPORATION ACT (Continued)

par value stock if that jurisdiction interprets Minnesota law favorably to the corporation.

k. *Consideration for Shares.* Unless the Articles otherwise provide, a written agreement is required to issue shares on the promise of the future transfer of consideration to the corporation.<sup>120</sup> Minority shareholders may want the Articles to provide that the corporation will issue shares only for cash in order to prevent the majority shareholders from issuing an excessive amount of stock in exchange for services to be rendered.

l. *Stock Dividends.* Absent contrary Article provisions, and unless approved by the holders of a majority of the voting power of a class of shares, shares of such a class cannot be issued to holders of other classes of shares as a stock dividend.<sup>121</sup> If the corporation has more than one class of stock, this presumption may be critical for minority shareholders in order to prevent the dilution of their interest in the corporation.

m. *Preemptive Rights.* Unless the Articles state otherwise, shareholders have certain preemptive rights to purchase securities of the corporation before the corporation may offer them to other persons.<sup>122</sup> A preemptive right is the right of a shareholder to acquire a certain fraction of the unissued securities or rights to purchase securities of a corporation before the corporation may offer them to other persons. These rights are critical to minority shareholders to prevent the dilution of their interest in the corporation.

n. *Act of the Shareholders.* Generally, an affirmative vote by the holders of a majority of the voting power of the shares present and entitled to vote is required to take action at a shareholders' meeting unless the Articles otherwise provide.<sup>123</sup> Minority shareholders may wish to have the Articles provide that a greater majority of the voting power of the shares is required to take action. Alternatively, the minority shareholders may wish to bargain for a veto power over certain corporate actions, such as a major loan of

funds for expansion purposes.

o. *Reissuance of Shares Acquired by the Corporation.* Shares of the corporation reacquired by the corporation may be reissued.<sup>124</sup> If the Articles provide that corporate shares may not be reissued, the reacquisition of shares by the corporation will cause an automatic reduction of the number of authorized shares in the corporation, and the corporation must then file a statement of this reduction with the Secretary of State.<sup>125</sup> If the corporation later decides to reissue such shares, the Articles must be amended to permit this action.

p. *Shareholder Approval of Plans of Merger or Exchange.* Shareholders of the surviving or acquiring corporation need not approve a plan of merger or exchange if the interests of such shareholders are not materially affected by the plan.<sup>126</sup>

### 3. Procedure for Incorporation.

a. *Filing the Articles.* A signed and acknowledged<sup>127</sup> original of the Articles must be filed with the Secretary of State.<sup>128</sup> The filing of the Articles may be made by the incorporators of the corporation.

b. *Fees for Incorporation.* The New Act requires payment to the Secretary of State of \$85.00, which includes a \$15.00 filing fee and a \$70.00 incorporation fee.<sup>129</sup>

### B. BYLAWS.

The following are mandatory provisions unless otherwise indicated in the Bylaws or Articles.

#### 1. Regular Meetings of Shareholders.

a. *Place.* Meetings may be held anywhere, except when meetings are called on the demand of the shareholders.<sup>130</sup> The latter meetings must be held in the county where the corporation's principal executive office is located.<sup>131</sup>

b. *Time.* The time of a shareholders' meeting can be fixed in either the Bylaws or the Articles.<sup>132</sup>

c. *Frequency.* The New Act eliminates the requirement for an annual shareholders' meeting.<sup>133</sup> Although there is no requirement for an annual meeting, it is wise for the corporation to conduct such a meeting in order to ratify the officers'

salaries and the accountant's financial reports for the fiscal year.

d. *Notice.* Notice of a shareholders' meeting generally must be given to all holders of voting shares.<sup>134</sup> The notice is deemed received when given.<sup>135</sup> Notice is given by a shareholder to the corporation by mailing the notice to the corporation or an officer at the corporation's regis-

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<sup>120</sup>Minn. Stat. §302A.405 (1)(a) (1982). The Old Act did not require a written agreement, and thus stock could be issued on an oral promise to pay. Minn. Stat. §301.15 (1) (1980).

<sup>121</sup>Minn. Stat. §302A.405 (1)(b) (1982). This presumption protects minority shareholders in that the issuance of additional shares of a class to other classes significantly modifies the first class's investment contract. No equivalent provision exists under the Old Act.

<sup>122</sup>Minn. Stat. §302A.413 (1) (Supp. 1981). The Old Act also required the Articles to deny or limit preemptive rights to acquire stock. Minn. Stat. §301.04 (9) (1980).

<sup>123</sup>Minn. Stat. §302A.437 (1) (1982). For certain shareholder actions, a majority of all the shares entitled to vote must ratify the proposition. See, e.g., Minn. Stat. §302A.613 (2) (Supp. 1981) (shareholder approval for plans of merger or exchange). The Old Act has no set presumptive vote requirement for shareholder action.

<sup>124</sup>Minn. Stat. §302A.553 (1) (Supp. 1981). The Old Act does not specify the status of stock reacquired by a corporation. See Minn. Stat. §301.22 (6) (1980).

<sup>125</sup>Minn. Stat. §302A.553 (2) (Supp. 1981).

<sup>126</sup>Minn. Stat. §302A.613 (3) (1982). The Old Act always required approval by the shareholders of each corporation. Minn. Stat. §301.42 (2) (1980).

<sup>127</sup>The acknowledgment must comply with the Uniform Recognition of Acknowledgments Act. Minn. Stat. §§358.32-.40 (1980). Minn. Stat. §302A.011 (1) (Supp. 1981).

<sup>128</sup>Minn. Stat. §302A.011 (1) (Supp. 1981). See Minn. Stat. §301.06 (1) (1980). The Old Act also required the Secretary of State to file the Articles with the county recorder of the county in which a corporation's registered office is located. Minn. Stat. §301.07 (1980). The New Act has no such requirement.

<sup>129</sup>Minn. Stat. §302A.153 (Supp. 1981).

<sup>130</sup>Minn. Stat. §302A.431 (2) (1982) provides that shareholders holding three percent of the voting power of all shares entitled to vote at a shareholders' meeting may demand such a meeting if one has not been held during the immediately preceding fifteen months.

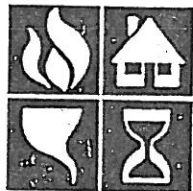
<sup>131</sup>Minn. Stat. §302A.431 (3) (Supp. 1981).

<sup>132</sup>*Id.*

<sup>133</sup>Minn. Stat. §302A.431 (1) (Supp. 1981). But see *supra* note 130.

<sup>134</sup>Minn. Stat. §302A.435 (1) (1982).

<sup>135</sup>Minn. Stat. §302A.011 (17) (1982).



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## INCORPORATION ACT (Continued)

tered or principal executive office address.<sup>136</sup> Notice also may be given orally.<sup>137</sup> Notice of a shareholders' meeting must be given at least ten days prior to, but no earlier than sixty days before, a meeting.<sup>138</sup> Shareholders may waive notice in writing or orally, or by attendance at a meeting without stating an objection.<sup>139</sup>

**e. Business to be Conducted.** If Directors' terms have expired or will expire within six months before or after a scheduled shareholders' meeting, shareholders must elect new Directors at such a meeting.<sup>140</sup> Any other appropriate business may also be transacted,<sup>141</sup> including the consideration of shareholders' proposals.

### 2. Special Meetings of Shareholders.

**a. Who May Call.** The chief executive officer, the chief financial officer, two or more Directors, shareholders holding at least ten percent of the corporation's voting power, or any other person authorized by the Articles or Bylaws may call a special meeting.<sup>142</sup>

**b. Notice.** Notice of special meetings must be given as required for regular shareholders' meetings.<sup>143</sup> Special meetings held on shareholder demand<sup>144</sup> must be called within thirty days after receipt of the demand.<sup>145</sup>

**c. Time and Place.** Meetings may be held at any time and place fixed by the chief executive officer, the Board, or any person authorized in the Articles or Bylaws to call meetings.<sup>146</sup> However, meetings called on shareholder demand<sup>147</sup> must be held in the county where the corporation's principal executive office is located.<sup>148</sup>

**d. Business to be Conducted.** Business at a special shareholders' meeting is limited to those matters specified in the notice of the meeting.<sup>149</sup>

### 3. General Provisions Concerning Shareholders' Meetings.

**a. Quorum.** Unless otherwise provided in the Bylaws, the New Act provides that the holders of a majority of the voting power of the shares entitled to vote at a meeting constitute a quorum.<sup>150</sup> A high

quorum, such as a two-thirds requirement, may favor minority shareholders who may delay consideration of matters adverse to their interests by not attending a meeting.

**b. Voting Rights.** See *supra* §§I.A.2.f., II.A.2.j. The number of votes per share also may be altered in the Bylaws.<sup>151</sup>

**c. Vote Required for Action.** See *supra* §II.A.2.n.

**d. Proxies.** Shareholder proxies are presumptively valid for eleven months and may be revoked unless coupled with an interest.<sup>152</sup> "Coupled with an interest" means an appointment of a proxy under the terms of a shareholder control agreement (see *supra* §II.2.) or under another agreement where consideration passes to the shareholder in exchange for services rendered, credit extended, or rights to purchase or dispose of shares.<sup>153</sup> Where a shareholder appoints multiple agents, a majority of the proxies will control the voting of the shares unless the proxy appointment otherwise provides.<sup>154</sup> If the proxies are evenly divided, the shares cannot be voted unless the proxy appointment instructs the method of voting such shares.<sup>155</sup>

**e. Action Without a Meeting.** The New Act permits written action to be taken without a shareholders' meeting if signed by all shareholders entitled to vote on that issue.<sup>156</sup> However, unanimous action may be required for some purposes. For example, unanimous written action of the shareholders is probably required for approval of an incentive stock option plan under the Internal Revenue Code.<sup>157</sup>

**f. Record Date for Determination of Shareholder Status.** Unless the Articles or Bylaws otherwise state a shorter time, the Board may determine shareholder status as of a date not more than sixty days before the meeting.<sup>158</sup>

### 4. Directors.

**a. General Management Powers.** The Directors traditionally have the power to manage the corporation's business affairs. However, the holders of all the shares entitled to vote for Directors can take unanimously any action that ordinarily would be taken by the Board.<sup>159</sup>

**b. Number.** Only one Director is required under the New Act.<sup>160</sup>

**c. Qualifications.** A Director can be any natural person for whom additional qualifications (i.e., shareholder status) can be specified in the Articles or Bylaws.<sup>162</sup>

**d. Term.** The New Act provides that a Director's term of office is indefinite.<sup>161</sup> If fixed terms are set, they may not exceed five years.<sup>164</sup>

**e. Vacancies.** If the vacancy results from the creation of a new directorship, an affirmative vote of a majority of the Directors then serving is required to fill the vacancy.<sup>165</sup> All other vacancies can be filled by the affirmative vote of a majority

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<sup>136</sup>*Id.*

<sup>137</sup>*Id.*

<sup>138</sup>Minn. Stat. §302A.435 (2) (Supp. 1981). Cf. Minn. Stat. §301.25 (5) (1980) (no minimum notice period).

<sup>139</sup>Minn. Stat. §302A.435 (4) (Supp. 1981). Cf. Minn. Stat. §301.25 (6) (1980) (waiver must be in writing).

<sup>140</sup>Minn. Stat. §302A.431 (4) (Supp. 1981).

<sup>141</sup>*Id.*

<sup>142</sup>Minn. Stat. §302A.433 (1) (1982). Cf. Minn. Stat. §301.25 (3) (1980) (same provisions).

<sup>143</sup>See *supra* notes 134-39 and accompanying text.

<sup>144</sup>Minn. Stat. §302A.433 (2) (Supp. 1981). Shareholders holding ten percent of the voting power of the corporation's shares may demand a special meeting in writing.

<sup>145</sup>*Id.*

<sup>146</sup>Minn. Stat. §302A.433 (3) (Supp. 1981).

<sup>147</sup>See *supra* text accompanying notes 144-45.

<sup>148</sup>Minn. Stat. §302A.433 (3) (Supp. 1981).

<sup>149</sup>Minn. Stat. §302A.433 (4) (Supp. 1981).

<sup>150</sup>Minn. Stat. §302A.449 (2) (Supp. 1981).

<sup>151</sup>Minn. Stat. §302A.445 (3) (Supp. 1981). The Old Act permitted such an alteration only in the Articles.

<sup>152</sup>Minn. Stat. §301.26 (1) (1980).

<sup>153</sup>Minn. Stat. §302A.449 (2) (Supp. 1981).

<sup>154</sup>See Minn. Stat. Ann. §302A.449. Reporter's Notes, at 158-59 (West Supp. 1982).

<sup>155</sup>Minn. Stat. §302A.449 (5) (b) (Supp. 1981).

<sup>156</sup>*Id.* This reverses the Old Act's provision which permitted an equal division of the shares to be voted among the equally divided proxies. Minn. Stat. §301.26 (5) (1980).

<sup>157</sup>Minn. Stat. §302A.441 (Supp. 1981). The Old Act required the signature of all shareholders entitled to notice. Minn. Stat. §301.26 (11) (1980).

<sup>158</sup>See, e.g., IRC §422A (b) (1). Cf. Rev. Rul. 80-29, 1980-1 C.B. 93 (unanimous approval provision for written action to consent to qualified stock option plan under IRC §422 (b) (1)).

<sup>159</sup>Minn. Stat. §302A.445 (1) (1982).

<sup>160</sup>Minn. Stat. §302A.201 (1) (Supp. 1981). See Minn. Stat. §301.28 (1) (1980).

<sup>161</sup>Minn. Stat. §302A.201 (2) (1982). Shareholders may specifically enter into control agreements concerning any phase of the corporation's affairs. Minn. Stat. §302A.457 (1) (Supp. 1981). Any shareholder action under these provisions will relieve the Directors of all liability for the action taken, the burden of which then falls on the shareholders themselves.

<sup>162</sup>Minn. Stat. §302A.201 (2) (a), (b), 302A.457 (3) (Supp. 1981). The Old Act has no such provisions, which are of course beneficial to closely held corporations wishing to avoid the rigorous statutory requirements for Board action under the Old Act.

<sup>163</sup>Minn. Stat. §302A.203 (Supp. 1981). The Old Act required three Directors if three or more shareholders existed. Minn. Stat. §301.28 (1) (1980).

<sup>164</sup>Minn. Stat. §302A.205 (Supp. 1981).

<sup>165</sup>Minn. Stat. §302A.207 (1982). This changes the Old Act's presumption that a Director served for a fixed term of one year. Minn. Stat. §301.28 (4) (1) (1980).

<sup>166</sup>Minn. Stat. §302A.207 (1982).

<sup>167</sup>Minn. Stat. §302A.225 (a), (2) (Supp. 1981).

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## INCORPORATION ACT (Continued)

of the remaining Directors, even if a quorum is not present.<sup>166</sup>

### 5. Meetings of Directors.

a. *Who May Call.* Any Director may call a Board meeting at any time.<sup>167</sup>

b. *Notice.* Notice of a Board meeting must be given ten days in advance of the meeting.<sup>168</sup> However, no notice is required if the Articles or Bylaws specify the day or date, time, and place of a Board meeting (i.e., an annual Board meeting), if such information was announced at a prior meeting,<sup>169</sup> or if notice is waived.<sup>170</sup>

c. *Time and Place.* Meetings may take place where and when the Board selects. If the Board fails to select a location, the meeting is held at the principal executive office of the corporation.<sup>171</sup>

d. *Quorum.* Unless the Articles or Bylaws state otherwise, a majority of Directors holding office present at the beginning of a meeting constitutes a quorum, even though Directors withdrawing from the meeting leave fewer Directors than originally required for a quorum.<sup>172</sup> Vacant, but authorized directorships are not included in calculating the number of Directors required for a quorum. Therefore, if Directors are removed or resign, a smaller number of Directors may be required to constitute a quorum.

e. *Absent Directors.* If the Articles or Bylaws provide, Directors who will be unable to attend Board meetings may, in writing and prior to a meeting, indicate their position for voting on particular matters. Such consent or opposition to a proposal counts as a vote for or against the proposal, but does not count for determining a quorum.<sup>173</sup>

f. *Vote Required for Action.* Unless the Articles state otherwise, the Board generally takes action by the affirmative vote of a majority of Directors present at a meeting.<sup>174</sup>

g. *Action Without a Meeting.* If the Articles provide, and if the action does not require shareholder approval,<sup>175</sup> the Directors may consent to action in a writing signed by as few of that number of Directors required to take the same action at a Board meeting attended by all the Directors.<sup>176</sup> Directors not signing or consenting are absolved from liability arising out of the written action.<sup>177</sup> Such Directors must be informed of the text and its effective date.<sup>178</sup>

h. *Electronic Communications.* The New Act permits the use of any communication devices permitting all Directors to hear each other during a conference.<sup>179</sup>

### 6. Other Provisions Concerning Directors.

a. *Compensation.* Unless the Articles or Bylaws otherwise state, the Board may set Directors' compensations.<sup>180</sup>

b. *General Committees.* By majority vote of the Board, the Board may estab-

lish committees with full Board authority, but subject to Board control.<sup>181</sup> For example, the Board may establish a finance committee with full power to secure bank financing for corporate expansion.

c. *Committee of Disinterested Persons.* Unless prohibited by the Articles or Bylaws, the Board may establish a committee, not under its control, of disinterested persons. The committee has the authority to determine whether particular legal actions are in the corporation's best interests and whether to cause derivative actions on behalf of the corporation to be dismissed.<sup>182</sup>

d. *Indemnification of Directors.* Unless the Articles or Bylaws otherwise provide, the corporation generally must indemnify Directors and officers for expenses and penalties of lawsuits arising by reason of the former or present official capacity of the Director or officer.<sup>183</sup> If the Director is indemnified by another party for such expenses, however, the corporation has no duty of indemnification.<sup>184</sup> The corporation may purchase and maintain insurance on behalf of a corporate official in that person's official capacity against any liability asserted against and incurred by the person in or arising from that capacity, whether or not the corporation would have been required to indemnify the person against the liability.<sup>185</sup>

e. *Limitation of Director Liability for Acts Taken.* Directors must perform their duties in good faith with reasonable care.<sup>186</sup> Directors may reasonably rely on certain information provided by third parties.<sup>187</sup> For example, Directors may rely on opinions, reports, and statements, including financial statements, made by a trusted officer or employee, the corporation's counsel or public accountant, or a Board committee upon which the Director does not serve, if the committee action is within its scope of authority and the Director has confidence in the committee's ability.<sup>188</sup> Directors performing their duties as such are immune to liability for their actions as Directors.<sup>189</sup>

f. *Resignation of Directors.* A Director may resign by giving written notice to the corporation.<sup>190</sup> The resignation is effective without acceptance when the notice is given to the corporation, unless a later effective time is specified in the notice.<sup>191</sup> Once a Director resigns from the corporation, the Director is absolved from liability for actions taken thereafter by the corporation, but the Director remains liable for actions taken while a Director.

g. *Removal of Directors.* Unless the Articles, the Bylaws, or a shareholders' agreement otherwise provides, Directors may be removed with or without cause by shareholders at any time, and by Directors under certain circumstances.<sup>192</sup>

### 7. Officers.

a. *Required Officers.* One or more persons must have the responsibility (al-

though not necessarily the title) of the following officers:

i) *Chief Executive Officer.* This officer's duties are similar to those traditionally relegated to the corporate President and Secretary.<sup>193</sup>

ii) *Chief Financial Officer.* This officer's duties are similar to those traditionally relegated to the corporate Treasurer.<sup>194</sup>

b. *Other Officers.* The Board may wish to appoint other officers (i.e., a Secretary,

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<sup>166</sup>Minn. Stat. §302A.225 (a) (1) (Supp. 1981).

<sup>167</sup>Minn. Stat. §302A.231 (3) (Supp. 1981).

<sup>168</sup>*Id.* The notice must be given in the manner that applies to shareholder meetings. See *supra* text accompanying notes 134-39.

<sup>169</sup>Minn. Stat. §302A.231 (4) (Supp. 1981).

<sup>170</sup>Under the New Act, notice can be waived in writing, orally, or by attendance at a meeting without stating an objection. Minn. Stat. §302A.231 (5) (Supp. 1981). See also text accompanying note 139 (shareholder meetings).

<sup>171</sup>Minn. Stat. §302A.231 (1) (Supp. 1981).

<sup>172</sup>Minn. Stat. §302A.235 (Supp. 1981). Cf. Minn. Stat. §301.28 (4) (6) (1980) (proportion of Directors required can be altered by Bylaws, but minimum proportion is 1/3; quorum must be present through entire meeting in order to transact business).

<sup>173</sup>Minn. Stat. §302A.233 (Supp. 1981). The Old Act has no such provision.

<sup>174</sup>Minn. Stat. §302A.237 (Supp. 1981). But see *supra* text accompanying note 113.

<sup>175</sup>Certain major corporate actions, such as a merger, may require shareholder approval. See Minn. Stat. §302A.613 (2) (1982). In a situation where shareholder approval is required, a consent to action by the Board must be signed by all the Directors. Minn. Stat. §302A.239 (1) (Supp. 1981).

<sup>176</sup>Minn. Stat. §302A.239 (1) (1982). But see *supra* note 157 and accompanying text. The Old Act always required all Directors to sign a consent to action. Minn. Stat. §301.28 (4) (7) (1980).

<sup>177</sup>Minn. Stat. §302A.239 (3) (Supp. 1981).

<sup>178</sup>*Id.*

<sup>179</sup>Minn. Stat. §302A.231 (2) (Supp. 1981). See Minn. Stat. §301.28 (4) (10) (1980).

<sup>180</sup>Minn. Stat. §302A.211 (Supp. 1981). See Minn. Stat. §301.28 (4) (9) (1980).

<sup>181</sup>Minn. Stat. §302A.241 (1) (Supp. 1981). Cf. Minn. Stat. §301.28 (4) (8) (1980) (unanimous Board action required to establish committees).

<sup>182</sup>Minn. Stat. §302A.243 (1982). This provision is not found under the Old Act, and it has broad implications for publicly held corporations in Minnesota. See Note, *Minnesota Business Corporations Act: Greater Freedom for Corporations*, 66 Minn. L. Rev. 1033, 1051-60 (1982).

<sup>183</sup>Minn. Stat. §302A.521 (2) (a) (1982). See Minn. Stat. §301.095 (1980).

<sup>184</sup>Minn. Stat. §302A.521 (2) (a) (1) (1982).

<sup>185</sup>Minn. Stat. §302A.521 (7) (Supp. 1981). The Old Act restricted insurance coverage to those acts which could be indemnified under that law. See Minn. Stat. §301.095 (7) (1980).

<sup>186</sup>Minn. Stat. §302A.251 (1) (Supp. 1981). See Minn. Stat. §301.31 (1980).

<sup>187</sup>Minn. Stat. §302A.251 (2) (1982).

<sup>188</sup>*Id.*

<sup>189</sup>Minn. Stat. §302A.251 (1) (Supp. 1981).

<sup>190</sup>Minn. Stat. §302A.221 (Supp. 1981). Delivery of notice is to the "corporation" to avoid the concern that notice was sent to the incorrect officer. See Minn. Stat. Ann. §302A.221. Reporter's Notes, at 72-73 (West Supp. 1982).

<sup>191</sup>Minn. Stat. §302A.221 (Supp. 1981).

<sup>192</sup>Minn. Stat. §302A.223 (2), (3) (Supp. 1981). Cf. Minn. Stat. §301.29 (1980) (no provision for removal of Directors by Directors).

<sup>193</sup>Minn. Stat. §302A.305 (2) (Supp. 1981). Cf. Minn. Stat. §301.30 (1980) (Bylaws control all duties of officers).

<sup>194</sup>Minn. Stat. §302A.305 (3) (Supp. 1981).



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Vice-President, etc.),<sup>195</sup> although such additional officers are not required by the New Act.

c. *Term of Office and Compensation.* Officers serve<sup>196</sup> and are compensated<sup>197</sup> according to the provisions of the Articles or Bylaws, or as the Board determines.

d. *Indemnification of Officers.* See *supra* §II.B.6.d.

### 8. Certificates of Stock.

a. *Issuance of Shares.* See *supra* §§II.A.2.j., k., m.

b. *Form of Certificate.* The Articles or Bylaws should set out the form of stock certificates to be issued,<sup>198</sup> including the agent for signature,<sup>199</sup> whether facsimile signatures are permissible,<sup>200</sup> and what limitations or preferences may be placed upon such certificates.<sup>201</sup>

c. *Lost, Stolen, or Destroyed Certificates.* The Board may issue new certificates pursuant to the Uniform Commercial Code.<sup>202</sup>

d. *Stock Options or Other Rights to Purchase.* See *supra* §II.A.2.i.

e. *Transferability of Stock Certificates.* The Articles or Bylaws can set out the procedure for or the limitations on the transfer of stock certificates.<sup>203</sup>

### 9. Miscellaneous Provisions Concerning Bylaws.

a. *Dividend Distributions.* The New Act permits the Board to authorize and cause the corporation to make distributions at any time so long as the corporation will be able to pay its debts in the ordinary course of business.<sup>204</sup> Alternatively, the Bylaws might provide that dividends can be paid only out of earned surplus.

b. *Corporate Seal.* Corporations may have, but are not required to have, a corporate seal.<sup>205</sup>

c. *Fiscal Year.* The Bylaws may vest power in the Board to set a fiscal year.<sup>206</sup>

d. *Amendment of Bylaws.* See *supra* §II.A.2.d.

### e. Books and Records

i) *Storage.* The New Act requires the corporation to keep certain documents at its principal executive office, if within Minnesota, or at its registered office in Minnesota.<sup>207</sup>

ii) *Inspection and Copying of Documents.* Shareholders have absolute rights to examine and copy certain documents,<sup>208</sup> the expense of which is generally borne by the corporation.<sup>209</sup> Other corporate records can be obtained only upon a showing of a "proper purpose."<sup>210</sup> A "proper purpose" generally requires a shareholder's request for records to be related to the shareholder's "investment return."<sup>211</sup>

f. *Corporate Loans to Officers, Directors and Employees.* If a quorum is initially present, a majority of the Board<sup>212</sup> present at a meeting may approve such loans if they are made in the usual course of corporate business<sup>213</sup> or are reasonably expected

to benefit the corporation.<sup>214</sup> Shareholders may also approve such loans.<sup>215</sup>

## C. INITIAL CORPORATE MINUTES.<sup>216</sup>

1. *Approval of Articles.* A copy of the Articles should be attached in the minute book.

2. *Approval of Bylaws.* A copy of the Bylaws should be attached in the minute book.

3. *Approval of the Corporate Seal.*<sup>217</sup> A copy of the seal, if any, should be included in the minute book.

4. *Approval of Share Certificates.* A specimen copy of such certificates should be included in the minute book.

5. *Authorization to Issue Shares.* The Directors must authorize certain corporate officers to issue a certain number of shares of stock for a certain consideration.<sup>218</sup>

6. *Accepting Subscriptions for Shares.* The Directors should prepare a resolution accepting subscribers' offers to purchase shares of the corporation. The resolution should name the subscriber, the number of shares subscribed to, the par value of such shares, and the consideration paid. If the consideration is not in cash, the Directors must value the property or services offered in exchange for the stock issued.<sup>219</sup> The stock ledger book should reflect these transactions.

7. *Organizational Expenses.* The Internal Revenue Code permits a corporation to amortize its organizational expenditures over a period of not less than 60 months beginning with the month in which the corporation begins its business.<sup>220</sup> Such an election should be made in the initial corporate minutes.

8. *Election of Corporate Officers.* Generally, the election term for officers is not fixed, and termination of officership is at the pleasure of the Directors. Salaries for such officers may be fixed, or consideration of this matter may be deferred.

9. *Small Business Corporation Election.* The organizational minutes should identify the corporation's stock as Section 1244 stock,<sup>221</sup> and may state that the corporation elects to be taxed under Subchapter S.<sup>222</sup>

10. *Bank Resolution.* The Directors must authorize the creation of corporate bank accounts, and must identify which officers have authority to bind the corporation by signing checks or loan agreements. The corporation's bank will often provide a specific form to memorialize the Directors' actions on such matters. Generally, the corporation President and Treasurer are given authority to sign checks. The President is generally given the authority by the corporation to represent the corporation with respect to other major affairs.

11. *Authorization to Qualify as a Foreign Corporation.* The Directors should pass a resolution authorizing the appropriate officers to do whatever is

necessary to qualify the corporation to do business in other jurisdictions. Failure of the corporation to qualify to do business in another state may prevent the corporation from utilizing that state's courts to bring an action arising with respect to corporate matters.

12. *Authorization to Use a Commercially Assumed Name.* Minnesota requires that the corporation file a statement of the corporation's true name before permitting the corporation to use an assumed name for business purposes.<sup>223</sup> The Directors should authorize the filing of this statement.

<sup>195</sup>Minn. Stat. §302A.311 (Supp. 1981).

<sup>196</sup>*Id.*

<sup>197</sup>The New Act does not address this issue specifically.

<sup>198</sup>Minn. Stat. §302A.417 (4) (Supp. 1981). See Minn. Stat. §301.18 (5) (1980).

<sup>199</sup>Minn. Stat. §302A.417 (2) (Supp. 1981). The New Act requires only one signature on a stock certificate. Cf. Minn. Stat. §301.18 (4) (1980) (signature by president and secretary).

<sup>200</sup>Minn. Stat. §302A.417 (3) (Supp. 1981).

<sup>201</sup>Minn. Stat. §302A.417 (5) (Supp. 1981).

<sup>202</sup>Minn. Stat. §302A.419 (1) (Supp. 1981). The shareholder must allege the loss, theft, or destruction of the certificate under Minn. Stat. §336.8-405 (1976).

<sup>203</sup>Minn. Stat. §302A.429 (1) (Supp. 1981). Shareholder resolutions or agreements among shareholders may also control stock transferability. *Id.*

<sup>204</sup>Minn. Stat. §302A.551 (1) (1982). Cf. Minn. Stat. §301.22 (2) (1980) (distributions generally made out of surplus only).

<sup>205</sup>Minn. Stat. §302A.163 (Supp. 1981). See Minn. Stat. §301.09 (3) (1980).

<sup>206</sup>No specific provision in the New Act addresses this issue. See generally Minn. Stat. §302A.463 (Supp. 1981) (reference to fiscal year financial statements).

<sup>207</sup>Minn. Stat. §302A.461 (1), (2) (1982). See Minn. Stat. §301.34 (1), (2) (1980).

<sup>208</sup>Minn. Stat. §302A.461 (4) (a) (Supp. 1981). The Old Act did not give shareholders any absolute right to inspect or copy documents. See Minn. Stat. §301.34 (5) (1980).

<sup>209</sup>Minn. Stat. §302A.461 (5) (Supp. 1981). This provision has no predecessor under the Old Act.

<sup>210</sup>Minn. Stat. §302A.461 (4) (b) (Supp. 1981).

<sup>211</sup>See *State ex rel. Pillsbury v. Honeywell*, 291 Minn. 322, 327, 191 N.W.2d 406, 410 (1971); Minn. Stat. Ann. §302A.461 Reporter's Notes, at 168-69 (West Supp. 1982).

<sup>212</sup>Minn. Stat. §302A.501 (1) (Supp. 1981). See Minn. Stat. §301.32 (1980).

<sup>213</sup>Minn. Stat. §302A.501 (1) (a) (Supp. 1981).

<sup>214</sup>Minn. Stat. §302A.501 (1) (c) (Supp. 1981).

<sup>215</sup>Minn. Stat. §302A.501 (d) (Supp. 1981) requires the affirmative vote of the holders of 2/3 of the outstanding shares of the corporation.

<sup>216</sup>Minn. Stat. §302A.171 (2) (Supp. 1981) requires the incorporators or the Directors named in the Articles to take written action to complete corporate organization, unless a majority of such persons request a meeting to complete the matters. If a meeting is held, three days' notice must be given. *Id.* A sample form of organizational minutes can be found in J. Move, *Minnesota Corporations* 130 (1982).

<sup>217</sup>See *supra* text accompanying note 91.

<sup>218</sup>See *supra* text accompanying note 23.

<sup>219</sup>Minn. Stat. §302A.405 (1) (a) (Supp. 1981).

<sup>220</sup>IRC §248 (a).

<sup>221</sup>See *supra* text accompanying notes 26-29.

<sup>222</sup>See *supra* text accompanying notes 30-33. The shareholders' election should be attached in the minute book.

<sup>223</sup>See *supra* text accompanying note 73.