

MEETING WITH MYSELF

The Significance of a Small Company's Annual Meeting

Alena Herranen, Attorney at Law

April 1, 2011

“Why do I need to have an annual meeting of shareholders?” a client asked me after forming a corporation. “I’m the only shareholder. Do I stand in front of the mirror and discuss the issues with myself?”

The annual meeting requirement does seem silly for small corporations, especially if all of the shares are owned by one person or by a married couple, and those one or two shareholders are also the officers and directors. Nevertheless, there is no convenient small business exemption to the annual meeting requirement.¹ The California Corporations Code Section 600(b) states:

“An annual meeting of shareholders shall be held for the election of directors on a date and at a time stated in or fixed in accordance with the bylaws.”

What do you do at an annual shareholder meeting?

The primary purpose of the annual shareholder meeting is reiterated in Section 301(a) stating in part “at each annual meeting of shareholders, directors shall be elected to hold office until the next annual meeting.” In addition to the election of directors, Section 600(b) provides that “any other proper business may be transacted at the annual meeting.”

Proper business for a shareholder meeting includes electing and removing directors, amending the articles of incorporation, adopting or amending bylaws, changing corporate structure, and approving transactions between the corporation and the officers and directors. This last item may include the approval of salaries, bonuses, benefits, reimbursements, and any other payments made to or for the benefit of officers and directors.

How hard is it to hold a meeting?

Holding a shareholder meeting is not difficult unless there is significant disagreement among the shareholders. On the other hand, it is not as simple as sitting down for a cup of coffee when you have some free time. Shareholder meetings must comply with a number of requirements including prior written notice of the meeting at least ten days prior to the meeting (or waiver of notice) and the recording of minutes.

¹ Statutory close corporations may operate with more flexibility but must comply with other requirements. Because these are less common corporate forms, I do not address statutory close corporations in this article.

Is there an alternative to having an annual meeting?

Fortunately, small business owners often find relief from the formalities of annual shareholder meetings by signing a unanimous written consent action in lieu of the annual meeting. Written consent actions are easier for small business owners because there is no notice requirement, they need not state a specific time, date and place of a meeting, and the consent can be prepared and signed at the shareholders' convenience at some time around the date of the annual meeting.

A written consent in lieu of an annual meeting is authorized by Section 603(a), which provides:

“Unless otherwise provided in the articles, any action that may be taken at any annual or special meeting of shareholders may be taken without a meeting and without prior notice, if a consent in writing, as specified in Section 195, setting forth the action so taken, shall be provided by the holders of outstanding shares having not less than the minimum number of votes that would be necessary to authorize or take that action at a meeting at which all shares entitled to vote thereon were present and voted.”

Why is unanimity required for a written consent action?

Action by written consent does not require unanimous consent unless the shareholders are electing directors. As a practical matter, this means that every annual written consent must be unanimous because the election of directors is required annually. California Corporations Code Section 603(d) states:

“[D]irectors may not be elected by written consent except by unanimous written consent of all shares entitled to vote for the election of directors.”

What happens if the corporation does not hold an annual shareholder meeting or written consent action?

If a corporation fails to hold an annual meeting, one consequence is that the shareholders may seek a court order to hold a meeting and elect directors. This is obviously not a likely outcome in a single shareholder scenario unless the shareholder is Dr. Jeckyll and Mr. Hyde.

More pertinent to small corporations is the risk of “alter ego” liability.² The failure to hold an annual meeting or to execute an annual written consent is a factor considered in determining whether the corporation is simply the shareholders’ alter ego as opposed to a separate entity. If a claimant can demonstrate that (1) the shareholders do not treat the corporation as a separate entity but rather as an alter ego and (2) upholding the corporate entity would “sanction a fraud or promote an injustice,” then the shareholders may become individually liable for claims made against the corporation.

In the plaintiffs’ efforts to pierce the corporate veil under the alter ego doctrine, the plaintiffs will attempt to demonstrate that the shareholders:

1. Failed to observe corporate formalities such as electing directors, appointing officers, holding meetings and keeping minutes;
2. Commingled personal and corporate funds;
3. Used corporate assets as their own; or
4. Failed to contribute capital, issue stock or complete the formation of the corporation.

Complying with the annual meeting or written consent requirement helps refute alter ego claims by providing documentary evidence of the shareholders’ respect for the corporation’s separate existence.

Is it necessary to mention officers and directors in the minutes or written consent?

Another paper trail benefit is that the minutes or written consent provides proof that the corporation has officers and directors as required by Sections 212(a) and 312(a). Corporations must have three directors unless there are less than three shareholders. If there is one shareholder, there may be one director. If there are two shareholders, there may be two directors. Corporations must also have a chairman of the board or a president or both, a secretary, and a chief financial officer.

When the shareholders hold the officer and director titles, they must remember that the duties and powers of shareholders, directors and officers are different. They must know “which hat to wear” for each event or transaction to maintain the separation of the shareholder from the corporation. A generalized and simplified rule of thumb is that shareholders are responsible for electing directors, directors are responsible for appointing officers, and officers manage the corporation.

² The lack of formalities by statutory close corporations is not a basis for alter ego liability. See Section 300(e).

Is the board required to meet annually too?

While shareholders must have a meeting or execute a unanimous written consent annually to elect directors, the directors are not required by statute to meet annually. Nevertheless, it is customary to hold a board meeting immediately following the shareholder meeting. In lieu of a board meeting, the board may execute a unanimous written consent action. Note that this differs from shareholder written consent actions in that all board actions by written consent must be unanimous whereas most shareholder actions require only a majority vote.

What should we do to be compliant?

If your corporation's records need to be updated, please send me an email. It is inexpensive and requires very little effort to comply with the law and maintain your corporate shield.



www.herranenlaw.com

For more information:

California Corporations Code

www.leginfo.ca.gov

California Secretary of State

www.ss.ca.gov

California Department of Corporations

www.corp.ca.gov

California Secretary of State

<http://www.sos.ca.gov/business/notary/authentication.htm>