Though LLCs have become a default choice of entity for many businesses, corporations – C Corps and S Corps – still produce optimal results for many family-held businesses or businesses operating in industries where the corporate is preferred or required. The founding documents of corporations – Articles of Incorporation, Stockholders’ Agreements, and bylaws – are complex, interlocking instruments that create and regulate the capital structure, governance, and finance of the business. Very important issues of who can own stock, how that stock is valued and transferred, how major corporate decisions are made, and how disputes are resolved are all determined by these documents. This program will provide you with a practical guide to planning and drafting the essential founding documents of corporations.

**Part 1 – September 26, 2018:**

- Practical planning and drafting founding documents
- Counseling clients about the allocation of voting power and distribution preferences
- Framework of law – what’s required, what can be modified, what’s discretionary
- Defining common stock characteristics – classes, voting rights
- Uses of preferred stock – classes, rights, preferences
- Tax issues to consider when drafting founding documents

**Part 2 – September 27, 2018:**

- Instituting boards of directors – duties, restrictions, indemnification
- Approval of shareholders – major transactions, voting thresholds, procedures
- Restrictions on the transferability of stock
- Major components of corporate bylaws
- Common traps in drafting founding documents – avoiding later litigation

**Speaker:**

**Eric J. Zinn** is of counsel in the Denver office of Kutak Rock, LLP. He represents clients in matters involving corporate, individual and partnership taxation, state and local taxation, and corporate mergers, acquisitions and finance. He is a frequent lecturer on topics including the proper choice of legal entity for the operation of a business enterprise, drafting operating agreements for limited liability companies, international taxation, partnership taxation, and like-kind exchanges. He is an Adjunct Professor at the University of Colorado-Denver Business School and at the University of Colorado School of Law in Boulder. He is the author of "Colorado Limited Liability Company Forms and Practice Manual," published by Data Trace Publishing. Before entering private practice he served as a judicial clerk to the U.S. Tax Court. Mr. Zinn earned his B.A. from the University of the South, J.D. and LL.M. in taxation from the University of Florida College of Law, and M.S. in finance, M.S. in information systems, and M.B.A. from the University of Colorado-Denver.
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Teleseminar
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Drafting Articles of Incorporation & Bylaws, Part 2
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Date:         September 27, 2018

Seminar Title: Founding Documents: Drafting Articles of Incorporation & Bylaws, Part 2

Location:     Teleseminar - LIVE

Credits:      1.0 MCLE General Credit

Program Minutes:  60 General

Luncheon addresses, business meetings, receptions are not to be included in the computation of credit. This form denotes full attendance. If you arrive late or leave prior to the program ending time, it is your responsibility to adjust ČLE hours accordingly.
CORPORATE DOCUMENTS – PART ONE

Eric Zinn
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Assumption

• Entity taxed as a corporation
• Entity to conduct a business for profit
• Entity created under the laws of a U.S. state
Choice of Entity

• Choice of Entity
  • Taxation -- taxable v. nontaxable
  • Classification -- Check-the-box regulations
Choice of Entity -- Taxation

- Taxation

Nontaxable

- Partnership/LLC
- Single Member Entity

Taxable

- S Corp
- C Corp
Choice of Entity -- Classification

• Check-the-Box Rules – Treas. Reg. sections 301.7701-1 through -4
  • -4 – Trusts
  • -1 – General rules
  • -2 – Corporations
  • -3 – Default rules; Check the box
Choice of Entity -- Classification

- Automatic corporations
  - Entities incorporated under state corporation laws
  - Associations
  - Joint-stock companies
- Insurance companies
- Banking entities
- Entities wholly owned by a political subdivision
- Entities taxable as corporations under provisions of the Internal Revenue Code, other than § 7701(a)(3)
- Certain designated foreign entities
Choice of Entity -- Classification

• One-Member Entities
  • Default Rule: Disregarded as an entity separate from its owner
Choice of Entity -- Classification

- One-Member Entities
  - Elective Rule: Taxable as an association/corporation
Choice of Entity -- Classification

- Two-Member Entities
  - Default Rule: Taxable as a partnership
Choice of Entity -- Classification

- Two-Member Entities
  - Elective Rule: Taxable as an association/corporation
Disregarded Two-Member Entity

Land Contract, Relinquished Property

§ 1031 Qualified Intermediary

Grantor Trust

100%

Trust Corp.

Replacement Property

LLC

Replacement Property

- LLC required by Lender
- LLC decisions made by Trust
- All profits, credits, and losses allocated solely to Trust
- All distributions solely to Trust
- Held – No Culbertson intent to form a partnership, therefore, LLC is disregarded for tax purposes; transfer of replacement property to LLC treated as transfer to Trust for purposes of § 1031. (P.L.R. 199911033)
Choice of Entity -- Classification

• Bottom-line

Corporate tax status can be achieved in one of two ways:

  a. Through formation under a corporate statute
  b. Through a check-the-box election

IRS Forms 8832 or 2553
Choice of Entity -- Classification

• Why the choice is important?

  Need to determine what statute you want to operate under and why?

  a. For a single-member entity, can choose to form under the corporate statute or under the limited liability company (LLC) statute.

  b. For a multi-member entity, the sky is the limit. Can choose between the corporate statute, the LLC statute, a partnership statute, etc.
Choice of Entity -- Classification

- Statutory factors affecting decision:
  - Formalities
  - Management
  - Rights of creditors – charging order, etc.
  - Rights of equity owners
  - Fiduciary duties – owners, managers/directors
  - Minority rights
  - Dissenters’ rights
  - Familiarity
  - Access to records
  - Business in other jurisdictions
  - Determination of capital structure
  - Going public
Organizational Documents

• Articles/Certificate – filed with the Secretary of State
• Federal Employer Identification Number – IRS Form SS-4
• Colorado Business Registration – CR 100
• Denver-based companies need to file an Application for Denver Sales, Use, Lodgers Tax License and/or Occupational Tax Registration
• Organizational minutes
• Banking resolution
Organizational Documents

• Statutory Corporations – Look to CBCA for items to include in Articles or Bylaws; these offer planning opportunities
  • Decisions in Articles of Incorporation – CRS sections 7-102-102, 7-106-101
    • Share information – voting, preferences
    • Authorized
    • Classes
    • Cumulative voting for directors – CRS section 7-102-102(3)
    • Preemptive rights – CRS section 7-106-301
  • Bylaws
  • Shareholders’ Agreement
Organizational Documents

• Check-the-Box/Elective Corporations (assume LLC)
  • Articles of Organization – CRS section 7-80-204
    • Form of management
    • Operating Agreement
Framework -- Formalities

• What are the formalities for corporations and limited liability companies?

• Why should these formalities be followed?
  • Legal reasons
  • Practical reasons
What Are the Formalities of Which We Speak?

A. Corporations
   1. Need to file Articles of Incorporation
      • § 7-102-104: “All persons purporting to act as or on behalf of a corporation without authority to do so and without good faith belief that they have such authority shall be jointly and severally liable for all liabilities incurred or arising as a result thereof.”
      • § 7-102-102(2)(b)(V): The Articles of Incorporation may provide for “The imposition of personal liability on shareholders for the debts of the corporation to a stated extent and upon stated conditions.”
2. Business persons generally understand corporations because corporations have been around for a long time.
   - Familiarity from business law classes.
   - Public companies.
   - Popular culture.

3. Somewhat surprisingly there are not that many formalities.
   - There is no requirement to have an organizational meeting of the directors, can meet over the telephone or internet, can avoid meeting altogether with unanimous consents, the consents for shareholders do not need to be unanimous, no par value, no stock certificates, no officers.
   - Initial meeting of the Board of Directors is not mandatory (§ 7-102-105).
     - Advisable because this may be the one time when you have your client’s attention.
     - Lay the foundation for how the corporation will be run—bylaws, electing officers, banking resolutions, fiscal year, and other organizational matters.
What Are the Formalities of Which We Speak?

4. Conducting annual shareholder meetings is required (§ 7-107-101(1))
   • But “The failure to hold an annual meeting at the time determined pursuant to
     subsection (1) of this section does not affect the validity of any corporate action and
     does not work a forfeiture of dissolution of the corporation.” (§ 7-107-101(3))
   • Remedy is go to court for an order to hold the annual meeting. (§ 7-107-103)

5. Required Records and Inspection Rights
   • A corporation is obligated to keep as a permanent record (§ 7-116-101(1)) (Note,
     “permanent record” is undefined):
     • Minutes of meetings of shareholders, directors, and committees.
     • Appropriate accounting records.
     • Shareholder/Voting Groups arranged alphabetically.
What Are the Formalities of Which We Speak?

6. Required Records and Inspection Rights, cont’d

   • Corporation must also keep copies of certain records at the corporation’s principal place of business, including Articles, Bylaws, Shareholder Minutes, Shareholder communications for the past 3 years, names and addresses of current officers, most recent periodic report, and 3 years of financial statements. (§ 7-116-101(5))
     • A shareholder may inspect and copy these items, during regular business hours at the corporation’s principal office, on at least five business days’ written demand.
7. **Required Records and Inspection Rights, cont’d**

   - Shareholders have *qualified inspection rights* (§ 7-116-102(2)), meaning these records should likewise be maintained:
     - Excerpts from shareholder/board/committee minutes and consents, accounting records, and shareholder list.
     - Can inspect and copy (§ 7-116-102(3) only if the demand is made in *good faith* for a proper purpose (i.e., related to rights as a shareholder), the shareholder describes in reasonable particularity the purpose and records sought, how the records tie to the stated purpose of the inspection.
     - These rights cannot be abolished or limited in the Articles or Bylaws (§ 7-116-102(5)).
What Are the Formalities of Which We Speak?

B. LLCs—formalities even less than for Corporations
   
   1. File Articles of Organization
      
      • “All persons who assume to act as a limited liability company without authority to do so and without good faith belief that they have such authority shall be jointly and severally liable for all debts and liabilities incurred by such persons so acting.”
      
      • Similar to CBCA § 7-102-104 except “debts” expressly added to “liabilities incurred or arising as a result thereof.”
What Are the Formalities of Which We Speak?

B. LLCs—formalities even less than for Corporations, cont’d

2. But after the Articles of Organization are filed, the LLC Act requires little.
   • Do not need an Operating Agreement.
   • If you have an Operating Agreement, it does not need to be in writing.
   • But because an Operating Agreement can override most provisions of the LLC Act, as drafters we can create our own formalities for our clients.
     • If the Operating Agreement creates the formalities, the members and managers should honor them.
What Are the Formalities of Which We Speak?

B. LLCs—formalities even less than for Corporations, cont’d

3. Inspection Rights.

4. In a twist, the inspection rights for a member in a Colorado LLC are broader than for a shareholder in a Colorado corporation. Under § 7-80-408, members may inspect and copy:
   - information regarding the business and financial condition of the LLC
   - written resolutions and minutes, if any
   - federal, state, and local income tax returns for the LLC
   - a member list, including name and addresses
   - a copy of the LLC’s Articles of Organization and any written Operating Agreement of the LLC
   - information regarding the members’ capital contributions and capital commitment.
   - the date on which each member became a member of the LLC
   - “other information regarding the affairs of the LLC as is just and reasonable”
If there are not really that many formalities for corporations and LLCs to observe, why bother?

A. Corporations—areas where shareholders have potential exposure

1. Distributions

   • Definition of *distribution* is broad: “means a direct or indirect transfer by a corporation of money or other property, except its own shares, or incurrence of indebtedness by a corporation, to or for the benefit of any of its shareholders in respect of any of its shares. A distribution may be in any form, including a declaration or payment of a dividend; a purchase, redemption, or other acquisition of shares; or distribution of indebtedness.”

   • If a shareholder received a distribution that was improper (i.e., insolvency test or in violations of the Articles) (§ 7-106-401), then he or she is liable to the director if the shareholder knew the distribution was improper. (§ 7-108-403(2)(b))

   • However, a shareholder’s liability is limited by “the amount of the distribution to the shareholder that exceeds what should have been distributed to the shareholder.”

   • So, to protect both the directors and shareholders, the corporate records should show that the corporate distribution was proper.
If there are not really that many formalities for corporations and LLCs to observe, why bother?

A. Corporations—areas where shareholders have potential exposure

2. Corporate Veil Piercing

• Colorado’s state appellate courts have resolved claims under the alter ego doctrine at least 21 times. In those cases, the corporate veil has been pierced at least nine times and maintained at least 12 times. Federal courts applying Colorado law historically have pierced the veil in at least seven of 22 cases. (See Colorado Methods of Practice, §2.67 (8th ed.).)

• Time and time again, courts reaching decisions cite corporate formalities as a factor for piercing.
If there are not really that many formalities for corporations and LLCs to observe, why bother?

2. Corporate Veil Piercing, cont’d
   • Subtext is shareholders and directors are unlikely to observe corporate formalities if otherwise engaged in activities that could give rise to personal liability.
     • It would be strange for the corporate minutes to authorize commingling or diverting of funds and that the corporation is just a shell.
     • But the formalities required under the CBCA are so few in the overall scheme of things, and the cost is not great, that you should pressure your corporate clients to observe them.
     • Also note commingling of accounts.
   • Directors may still have some duty to creditors under *Alexander v. Anstine*, 152 P.3d 497 (Colo. 2007).
If there are not really that many formalities for corporations and LLCs to observe, why bother?

B. Limited Liability Companies

1. § 7-80-107(2): “For purposes of this section, the failure of a limited liability company to observe the formalities or requirements relating to the management of its business and affairs is not in itself a ground for imposing personal liability on the members for liabilities of the limited liability company.”
   - Suggests or admits that LLC operate less formally than corporations.

2. § 7-80-107(1): “In any case in which a party seeks to hold the members of a limited liability company personally responsible for the alleged improper actions of the limited liability company, the court shall apply the case law which interprets the conditions and circumstances under which the corporate veil of a corporation may be pierced under Colorado law.”
If there are not really that many formalities for corporations and LLCs to observe, why bother?

B. Limited Liability Companies, cont’d

3. LLC Act really underscores that LLCs are different:
   - § 7-80-108(4): “It is the intent of this article to give the maximum effect to the principle of freedom of contract and to the enforceability of operating agreements.”
   - § 7-80-109: “The rule that statutes in derogation of the common law are to be strictly construed shall have no application to this article.”
If there are not really that many formalities for corporations and LLCs to observe, why bother?

B. Limited Liability Companies, cont’d

4. Reinforced in *Weinstein v. Colborne Foodbotics, LLC*, 302 P.3d 263 (Colo. 2013) in which the Colorado Supreme Court said that managers of an insolvent LLC do not owe creditors the same fiduciary duties that corporate directors owe corporate creditors.

• “Because LLCs and corporations are different business entities, it is reasonable that the common law applicable to corporations does not apply to an LLC in the context of a claim for unlawful distribution. . . . Hence, we hold that absent express statutory authority, an LLC’s creditor may not assert a claim against the members of the LLC for unlawful distribution.”

• Declined to say whether *Anstine* is still good case law, so may have an instant where LLC law is driving corporate law.
If there are not really that many formalities for corporations and LLCs to observe, why bother?

C. Nevertheless, Colorado Court of Appeals upheld corporate veil piercing of LLC in *Martin v. Freeman*, 272 P.3d 1182 (Colo. App. 2012), and noted failure to follow formalities with respect to adequate records for one of the bases for the piercing.
Practical reasons to observe formalities

A. Following formalities provides attorneys an opportunity to reinforce what we can do to help preserve the limited liability that a client’s choice of entity offers to its owners and management.

B. Annual meetings are a great reason to meet with your clients.
   1. Legal checkup.
   2. Gives you an opportunity to discover new matters and projects on which you can assist -- a marketing opportunity.
Equity – Rights of Owners

• Voting
• Transferability
• Operating Distributions
  • Preferences
• Liquidating Distributions
• Rights to Additional Equity; Dilution – preemptive rights
Shares

• Authorized
• Issued
• Outstanding
• Par Value
Shares -- Preferred

- Cumulative
- Participating
- Callable/Redeemable
- Convertible

- Watch out for S corporations
“Shares” in the LLC Context

• Typically done through the creation of classes of Units.
  • The rights of the individual classes of Units would be provided in the operating agreement and would parallel the expression of classes of stock otherwise provided in the Articles of Incorporation. Note, however, that the operating agreement is not a “public” document, as are the Articles of Incorporation.
  • Also a need to file amendments to the Articles with the Secretary of State when the capital structure changes. No need in the context of the LLC.