THE CORPORATE RECORDS NOBODY THINKS ABOUT UNTIL SOMEONE ASKS FOR THEM

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Tags
Corporate Records
Limited Liability Company

INTRODUCTION

Forming a Delaware corporation or limited liability company ("L.L.C.") is remarkably easy. Remembering what to do with it afterwards can be another matter. We are frequently asked to form corporations and limited liability companies for use as blockers, holding companies, or acquisition vehicles in connection with a transaction. Understandably, the immediate focus is usually on getting the entity formed quickly so that the transaction can proceed. The entity itself may be only a small part of a much larger transaction, with most of the attention being paid to the purchase agreement, financing documents, or other agreements that the newly formed entity intends to enter into. Once the transaction is completed, however, the corporate records of the newly formed entity can easily become an afterthought. The issue often resurfaces months or years later when a lender, purchaser, investor, or foreign counsel asks to see them.

We have touched on many of the documents discussed below in previous articles dealing with the formation and governance of corporations and L.L.C.'s. We return to the subject here because we have recently encountered a number of situations in which questions have arisen concerning corporate records that actually exist, whether they accurately reflect the ownership and governance of the entity, and, sometimes most importantly, who is responsible for maintaining them.

WHAT DOES IT TAKE TO FORM A COMPANY?

A Delaware L.L.C. can be formed in a day by filing a certificate of formation with the Secretary of State of Delaware containing little more information than the name of the L.L.C. and the name and address of its registered agent and registered office in Delaware.[1] Similarly, a corporation can be formed very quickly by filing a certificate of incorporation.[2] This document requires a little more information, but not much. At a minimum, the certificate of incorporation of a typical stock corporation will set forth the name of the corporation, the address of its registered office and the name of its registered agent in Delaware, the purpose of the corporation, the number of shares the corporation is authorized to issue and their par value, and the name and address of the incorporator.[3]

There are, of course, numerous other forms of business entity available in the United States, including limited partnerships and general partnerships. For purposes of

1 6 Del. C. § 18-201(a).

2 8 Del. C. §§ 101, 103.

3 8 Del. C. § 102(a).

this article, we will focus on corporations and L.L.C.'s, the two entity types we most frequently encounter. Many of the recordkeeping issues discussed below, however, apply equally to other forms of business entity.

The filing of a certificate of formation or certificate of incorporation creates the entity, but it is only the first step in properly organizing and documenting it. The documents filed with the state provide relatively little information about how the entity is owned, governed or operated. Those matters are addressed in the governing documents and other corporate records that are created and maintained after formation.

Once the certificate has been filed, the filer receives a stamped copy from the Delaware Secretary of State confirming the formation of the entity. That copy is then sent to the client or, in many of our cross-border matters, to the instructing lawyer in another country. Often, the entity is needed within a short time frame and, once confirmation of formation is received, the immediate concern is simply to have the newly formed entity enter into the transaction for which it was created.

This is where formation and proper organization of the entity can become confused. The filing of the certificate means that the entity exists, but it does not necessarily mean that the person proposing to sign on its behalf has been properly authorized to do so. This can be a particular source of confusion in cross-border matters, where clients may be accustomed to an individual director having authority to act on behalf of a company. In a Delaware corporation, the business and affairs of the corporation are managed by or under the direction of its board of directors, and an individual director does not have authority to act unilaterally for the corporation merely by virtue of being a director.[4]

Sometimes, after the entity has been formed and the immediate transaction completed, that is the last anyone thinks about its corporate records until questions are asked months or even years later.

- Does the L.L.C. have a manager?
- Is one required?
- Where are the corporation's stock certificates—or were its shares uncertificated?
- Who are the current directors and officers?
- Who owns the entity and where is that ownership recorded?

Too often, the answers are not readily apparent from the company's records.

WHAT RECORDS SHOULD THE COMPANY HAVE?

Following incorporation, as mentioned above, the incorporator should appoint the initial director or directors. Bylaws should then be prepared, and the board should hold an organizational meeting, or act by written consent, to adopt the bylaws, appoint the officers and take the other actions necessary to organize the corporation. The initial shareholder will typically subscribe for the corporation's shares by signing

[4] 8 Del. C. § 141(a).

a subscription agreement setting out the number of shares to be purchased and the consideration to be paid. The board will then accept the subscription and authorize the appropriate officers, upon receipt of the subscription price, to issue the shares to the subscriber. The issuance should be recorded in the corporation's stock ledger and, if the shares are certificated, the appropriate stock certificate should be issued. Thereafter, the company's records should include subsequent actions taken by the board and shareholders, including changes in directors and officers and subsequent issuances or transfers of shares.

In many cases, particularly where a corporation is formed for use as a blocker, holding company, or acquisition vehicle, there may be little reason to issue a physical stock certificate. Care should nevertheless be taken in preparing the bylaws. Many forms of bylaws provide that each shareholder is entitled to receive a stock certificate, even though in practice no certificates are ever issued. If shares are intended to be uncertificated, the bylaws should contemplate that possibility and provide that the corporation's shares may be certificated or uncertificated. Whether or not certificates are issued, an accurate stock ledger recording the ownership and issuance of the shares should be maintained.

An L.L.C., on the other hand, generally has fewer formal requirements, and its L.L.C. Agreement generally controls the management and governance of the entity. Delaware does not require that an L.L.C. Agreement be in writing – some states, including New York, do – but it is nevertheless good practice to have a written agreement.[5] Apart from documenting the agreement among the members, the process of preparing one requires the owners to consider some of the basic questions concerning how the L.L.C. will operate.

An L.L.C. may be managed by its members or the members may appoint a manager to take responsibility for its management. The governance structure will ordinarily be set forth in the L.L.C. Agreement. Care should be taken, however, in deciding how much information to include in the agreement itself. For example, where an L.L.C. is to be manager-managed, we generally prefer that the L.L.C. Agreement provide for the appointment of a manager without identifying the individual who will hold that position. The manager can then be appointed by a separate written consent of the members. If the manager subsequently changes, the company's records can be updated with a simple resolution appointing the replacement rather than requiring an amendment to the L.L.C. Agreement. The same approach can be taken with officers appointed by the manager or members.

Ownership of an L.L.C. is also documented somewhat differently from ownership of a corporation. An L.L.C. interest is commonly expressed as a percentage interest, although in some transactions it may be preferable to divide the ownership into a specified number of units. Either approach can be provided for in the L.L.C. Agreement. Unlike shares of a corporation, it is relatively uncommon for L.L.C. interests or units to be represented by physical certificates. Instead, the members and their respective percentage interests or units are typically recorded on a schedule to the L.L.C. Agreement or in other ownership records maintained by the company.

This distinction can become important in cross-border transactions. We are sometimes asked by foreign counsel, investors or other parties to provide a "membership

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5 6 Del. C. § 18-101(9); N.Y. Ltd. Liab. Co. Law § 417(a).

certificate" evidencing ownership of an L.L.C. when no certificate has ever been issued or was required. The absence of a certificate does not mean that the ownership has not been properly documented. What is important is that the L.L.C.'s records clearly establish who its members are, and the interest held by each of them.

MAINTAINING THE CORPORATE RECORD

Preparing the appropriate organizational documents is, of course, only part of the process. Those documents also need to be signed, retained and updated as the ownership and management of the entity changes. An entity may have been properly organized when formed, but several years later its records may no longer provide a complete picture of who owns the entity, who manages it, or what corporate actions have been taken.

Maintaining these records does not necessarily require the continuing involvement of outside counsel. A company secretary, member of the legal department or other person within the organization can maintain the minute book and other corporate records. The important point is that responsibility for doing so should be clearly assigned and that the records should be updated when changes occur. Outside counsel may need to prepare documents relating to particular corporate actions, but there is no reason that the company's day-to-day recordkeeping cannot be handled internally.

This is not simply an issue that arises when a lender, purchaser, or other third party conducts due diligence. We recently spoke with a newly appointed C.E.O. of a U.S. company who was attempting to determine from the company's existing records who its current directors and officers were and what corporate actions had previously been taken. Changes in personnel over the years can mean that the people with knowledge of the company's history are no longer there to provide the answers. A company's corporate records should tell its corporate history without requiring the people who made that history to still be there to explain it.

This issue arose again in our practice only recently. Organizational documents had been prepared and sent to a client for signature with a request that the executed copies be returned for inclusion in the minute book. Some months later, we were asked to provide copies of all signed resolutions and consents relating to the company. The client had only some of the organizational documents in its files, and a complete set of executed documents had apparently never been assembled. The client sent the documents to someone else within the organization to be signed; the problem was making sure that the signed versions found their way back into the company's permanent records.

This is an area where both the company and its counsel need to pay attention. Sending a document to a client for signature should not necessarily be the end of the process. Even where outside counsel has not been asked to maintain the minute book, it is good practice to follow up for an executed copy of any corporate document it prepares and retain that copy in its own files.

DOES THE MINUTE BOOK STILL NEED TO BE A BOOK?

Traditionally, the documents described above would have been maintained in a physical minute book. There is no requirement, however, that a modern company's corporate records be kept in a leather-bound book sitting on a shelf. Both Delaware and New York permit corporate records to be maintained electronically, provided they can be converted into a legible written form.[6] For many companies, an organized electronic minute book is likely to be more practical and more accessible than its physical predecessor.

"The physical minute book may be disappearing, but the need for accurate corporate records remains an important task for corporate management."

What matters is not where the records are kept, but that they are complete and readily accessible, and that someone has responsibility for maintaining them. A carefully organized electronic folder containing the governing documents, stock or membership records, and signed board, shareholder, or member actions may serve that purpose perfectly well. A beautifully bound minute book containing only half of the company's records is suboptimal.

Foreign clients sometimes assume that the company's Delaware registered agent maintains these records. Generally, it does not. The registered agent performs an important statutory function in Delaware, including maintaining the company's registered office and receiving service of process (a legal document that initiates litigation) and official communications, but it should not be assumed to be the custodian of the company's minute book or other internal corporate records. Nor should the registered office be assumed to be the company's mailing address. This can be particularly important for foreign-owned companies that do not maintain a physical office in the United States and need to consider separately where ordinary business correspondence, bank statements and other mail should be sent.

None of this is particularly complicated. Forming a corporation or L.L.C. is relatively straightforward, and maintaining its corporate records should be as well. The difficulty arises when no one takes responsibility for ensuring that the documents created at formation are signed and retained and that the records are updated as the ownership, management, and affairs of the company change.

Good corporate records should allow someone coming to the company years later – whether a new director or officer, a lender, purchaser, investor or adviser – to determine who owns the company, who has authority to act for it, and what significant corporate actions have been taken without having to reconstruct its history from old emails or the recollections of former employees.

Whether those records are maintained in a traditional minute book or electronically is ultimately less important than whether they are complete, accurate and accessible. The physical minute book may be disappearing, but the need for accurate corporate records remains an important task for corporate management.

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[6] 6 8 Del. C. § 224; 6 Del. C. § 18-305(d); N.Y. Bus. Corp. Law § 624(a); N.Y. Ltd. Liab. Co. Law § 1102(d).