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ORGANIZATION OF CORPORATIONS

CHAPTER 1.4

WALTER J. BRISTOW, JR.*

INTRODUCTION

One of the major benefits, both to lawyers and to the business community, of the new South Carolina Business Corporation Act¹ is the establishment in Chapter Four of a greatly simplified procedure for the organization of corporations. This procedure will at once equate the form to the substance of modern practice, lighten the burden on the lawyer and his staff, decrease the time required for incorporation, and eliminate many currently vexing problems, including that of "de facto" or "de jure" existence.

Compared with the present law,² the procedure for incorporation under the new act is very simple. One or more incorporators execute articles of incorporation and deliver them, together with an attorney's certificate that the requirements for organization have been complied with and that the corporation is organized for a lawful purpose, to the Secretary of State, who files them. Upon this filing by the Secretary of State, the existence under law of the corporation (with certain exceptions in suits by the State) has begun.³ Although certain other steps must be taken before the corporation can commence doing business, no other meetings, documents, or filing are required to complete the incorporation.

Many of the now familiar procedures in connection with the creation of corporations have been eliminated entirely or greatly modified by the act. For example, no advertisement is required prior to incorporation. No stated amount of the capital stock need be subscribed to. The Secretary of State issues no "charter." And it is not necessary that any

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1. S. C. BUS. CORP. ACT OF 1962, 1962 ACTS AND JOINT RESOLUTIONS 847, 52 STAT. AT LARGE 1896.

2. S. C. CODE §§12-51, et seq. (1952).

3. S. C. CODE §§12-14.5 (Supp. 1962).

document be filed with a clerk of court. It is felt by many that the simplicity of the act in this regard is one of its best features, especially since the investing public and the business community are given greater protection than before through assured validity of incorporation.

Perhaps the easiest way to discuss the organization of corporations under the act is to follow Chapter Four, section by section. The arrangement of the sections in Chapter Four is essentially logical and closely follows the arrangement of this portion of the Model Act⁴ (sections 47 through 53). For convenience, the various topics will be separated by subheadings.

AUTHORITY TO ORGANIZE

It should be borne in mind that the new law is a *business* corporation law. This is made plain not only by the title⁵ of the act, but even more so by section 1.3, relating to the application of the act, and section 2.1, relating to corporate purposes. Thus the act does not apply to charitable, social or religious corporations, or other eleemosynary corporations. So far as the organization of corporations under the act is concerned, it is specifically provided in section 4.1 (a) that a corporation may be organized for "any lawful business."⁶ If the proposed corporation is not to conduct a business, then it should not be organized under the act.⁷

It is also provided in section 4.1 (b) that whenever there are special provisions in any other statute relating to the organization of particular types of corporations, or corporations created to engage in any particular type of business, the special provisions will prevail over any inconsistent requirements of the act. Some examples of such corporations would be railroad, steamboat and canal companies,⁸ medical

4. MODEL BUS. CORP. ACT, prepared by the Committee on Corporate Laws of the Section of Corporation Banking and Business Law of the American Bar Association, published by the Committee on Continuing Legal Education of the American Law Institute collaborating with the American Bar Association. Hereinafter cited simply as MODEL ACT.

5. S. C. CODE §12-11.1 (Supp. 1962).

6. The requirement that the business be a "lawful" one is new, the present law, S. C. CODE §12-52 (1952), stating that a corporation can be organized "for any purpose whatsoever." One doubts, however, that even the most brazen criminals would prejudice their case in advance by expressly stating that the business to be carried on was unlawful. See later discussion for the lawyer's role in this connection.

7. Chapter 12, Title 12, S. C. CODE (1952), is not repealed by the Act and remains in force for the incorporation of eleemosynary corporations.

8. S. C. CODE §§58-651, et seq. (1952).

service corporations,⁹ business development corporations,¹⁰ banks,¹¹ insurance companies,¹² etc. The practitioner should, therefore, always know the exact objective of his client in incorporating so that he can comply with any special provisions not found in the act.

INCORPORATORS

The act provides that "one or more persons" may organize a corporation. In this respect the act differs significantly from both the present law, which requires two incorporators,¹³ and the Model Act, which requires three.¹⁴ It is submitted, however, that to require more than one incorporator would be a needless concession to an outmoded concept and accomplish no useful purpose. Under the present law, the incorporators need have nothing whatever to do with the corporation except to call the subscribers together¹⁵ and certify to the Secretary of State that the requirements of incorporation have been complied with.¹⁶ Most often, under present practice, the incorporators consist of a lawyer and his secretary or clerk. Even the drafters of the Model Act admit that the incorporators must be "regarded as fictional in many cases" and can offer no better reason for requiring three incorporators than that such a requirement is "firmly established in most states."¹⁷ South Carolina, however, has long allowed less than three persons to act as incorporators, and our Supreme Court has specifically recognized that all of the stock of a corporation may be owned by one person without the corporation losing its identity as such.¹⁸ The new act merely recognizes that if one person can own a corporation, there is no reason why one person should not be allowed to create a corporation.

The new act also sets to rest the question of whether or not a corporation may act as incorporator for another corporation. Section 4.2 provides that the incorporator must be

9. S. C. CODE §§37-1101, et seq. (1952).

10. S. C. CODE §§12-1101, et seq. (1952).

11. S. C. CODE §§8-57 (1952).

12. S. C. CODE §§37-110 (1952).

13. S. C. CODE §12-52 (1952).

14. MODEL ACT §47.

15. S. C. CODE §12-52 (1952).

16. S. C. CODE §12-56 (1952).

17. *Preface to 1950 Revision of MODEL ACT*, p. vi.

18. *Gordon v. Hollywood-Beaufort Package Corp.*, 213 S. C. 438, 49 S. E. 2d 718 (1948).

a "person," but in section 1.2 "person" is defined as "an individual, a corporation (domestic or foreign), a partnership, an association, a trust or a fiduciary." That a corporation may act as incorporator is further evidenced by section 2.2(15) where, under the powers of corporations, is listed "to form, or acquire the control of, other corporations."

The persons who act as incorporators do not have to be residents of this State or subscribers to shares in the corporation, but they must have "capacity to contract." Although this phrase is not defined in the act, presumably infants¹⁹ and insane persons²⁰ cannot act as incorporators. In view of the generally understood meaning of the words, however, it can probably safely be said that, for practical purposes, any natural person over the age of 21 years and for whom no committee has been appointed, and any artificial person whose legal existence has not been terminated, can act as an incorporator.

Although the primary purpose of the incorporators is to file the necessary papers with the Secretary of State, they do have one other duty in connection with the organization of the corporation. That is to call an organizational meeting of the board of directors named in the articles of incorporation.²¹ This meeting will be discussed later in the article.²²

ARTICLES OF INCORPORATION

Section 4.3(a) of the act, which should be consulted for the exact wording and order, sets out in some detail what the articles of incorporation should contain. These include the name of the corporation, the nature of the corporate business, the period of duration of the corporation, the address of the corporation's registered office and the name of its registered agent, and the number, names and addresses of the directors

19. *State v. Satterwhite*, 20 S. C. 536 (1884); *Hack v. Metz*, 173 S. C. 43, 176 S. E. 314, 95 A. L. R. 196 (1934). The question whether an infant could ratify his acting as an incorporator after he reached maturity is dismissed as too abstruse for consideration here.

20. *Munday v. Mims*, 5 Strob. (36 S. C. L.) 132 (1850); *Sims v. McLure*, 8 Rich. Eq. (29 S. C. Eq.) 286, 70 Am. Dec. 196 (1856) — after commitment. Query as to incorporation made prior to commitment "in good faith, without fraud or imposition," etc., cf. *Dominick v. Rhodes*, 202 S. C. 139, 24 S. E. 2d 168 (1943).

21. S. C. CODE §12-14.7 (Supp. 1962).

22. The incorporators may possibly have one other final duty in connection with a corporation. If a corporation has not commenced business nor issued any shares, it may be voluntarily dissolved by the incorporators. S. C. CODE §12-22.1 (Supp. 1962).

of the corporation. The articles must also contain a statement that the corporation will not begin business until the minimum capital required by the act has been paid to the corporation, and information regarding the shares of stock which the corporation shall be authorized to issue. In addition, there may be included in the articles of incorporation any other provisions which are not contrary to law.

The name of the corporation must comply with the requirements of section 3.1. For the exact phraseology, of course, the words of the statute itself should be inspected. In general, however, the name of the corporation must contain the word "corporation," "incorporated," or "limited," or an abbreviation of one of such words. The name must not contain any word or phrase that implies that the corporation is organized for any purpose other than one or more of the purposes stated in its articles. It cannot be the same as or deceptively similar to the name of any other domestic corporation or of any foreign corporation authorized to do business in the state; nor to any name, the use of which has been reserved or which is registered by another corporation, without the consent of such corporation in writing. The name must not indicate that the corporation has the power to transact certain regulated businesses where authorization for entry into the field is required, unless the appropriate regulating agency has granted such authorization.²³ Also, the name cannot indicate that the corporation is affiliated with or sponsored by a fraternal, veterans, service, religious, charitable or professional organization unless it is so affiliated and that fact is certified in writing by the organization with which the corporation is affiliated.

The nature of the business for which the corporation is organized does not need to be stated with particularity. A brief statement of the general type of business should be sufficient. Enough should be stated, of course, to indicate that the business to be carried on is lawful.²⁴ It is not necessary to set forth any of the corporate powers enumerated in the act.²⁵ These powers are enumerated in section 2.2 and encompass all of the powers found in our present law²⁶ and include sev-

23. Examples would be banks [S. C. Code §8-101 (1952)]; and insurance companies [S. C. Code §37-110 (1952)], among others.

24. S. C. CODE §§12-12.1, 12-14.1 (a) (Supp. 1962).

25. S. C. CODE §§12-14.3(e), 12-12.2(b) (Supp. 1962).

26. S. C. CODE §§12-74, 12-101, 12-102 (1952).

eral others of current importance such as the right to make donations for charitable or other purposes and to establish and carry out pension plans, etc.

As in our present law,²⁷ the period of duration of corporations created under the act is perpetual unless it is specifically stated to be otherwise in the articles of incorporation.

The articles of incorporation may contain other provisions which may be authorized by other sections of the act or which relate to the business or affairs of the corporation, or the rights or powers of its shareholders, etc., which are not inconsistent with law. This is authorized in section 4.3(a) (8) and is an extremely important provision since many of the sections of the act provide for a rule of law, "except as otherwise provided by the articles," "subject to the articles," or similar language. Examples include the right to issue shares of preferred or special class stocks in series,²⁸ changes in rights of preferred shares,²⁹ issuance of redeemable shares,³⁰ issuance of convertible securities,³¹ number of shareholders required to constitute a quorum,³² required vote of shareholders to authorize corporate action,³³ voting rights of shares or bonds,³⁴ pre-emptive rights of shareholders,³⁵ and many other important matters in connection with the operation of a corporation. Sub-section (a) (8) thus gives to the attorney the opportunity to tailor the articles of incorporation so as to best meet the needs of his client, and provides for the flexible corporate structure so necessary for the continued economic growth of our State.

ATTORNEY'S CERTIFICATE

The articles of incorporation must be accompanied by a certificate, signed by an attorney licensed to practice in South Carolina, that all of the requirements of the chapter of the act relating to the organization of corporations³⁶ have been complied with, and that, in the opinion of the attorney, the

27. S. C. CODE §12-63 (1952).

28. S. C. CODE §§12-15.2, 12-15.3 (Supp. 1962).

29. S. C. CODE §12-15.4 (Supp. 1962).

30. S. C. CODE §12-15.18 (Supp. 1962).

31. S. C. CODE §12-15.24 (Supp. 1962).

32. S. C. CODE §12-16.8 (Supp. 1962).

33. S. C. CODE §12-16.10 (Supp. 1962).

34. S. C. CODE §12-16.11 (Supp. 1962).

35. S. C. CODE §12-16.21 (Supp. 1962).

36. S. C. BUS. CORP. ACT OF 1962, Chapter 4.

corporation is organized for a lawful and proper purpose. Although similar provisions have long been a part of the Blue Sky Laws of most states,³⁷ this is a requirement new to South Carolina law so far as the organization of corporations is concerned. The merits of the provision are obvious, however. Among other things, it aids the Secretary of State in the performance of his duties. Many statutes, including the Model Act,³⁸ require the Secretary of State to file the articles if they "conform to law." With the requirement of an attorney's certificate, the placing of the burden upon the Secretary of State to determine whether the proceedings have been proper is no longer necessary.

The attorney's certificate aids the prospective investor in the corporation in two ways. First, it assures him that his investment is to be made in an enterprise properly created and which will afford him the limited liability sought. Second, the requirement that the attorney certify that the corporation is created for a lawful purpose assures him that, at least so far as it is manifest in the articles, he is not participating in a criminal enterprise. While there is no doubt that "Murder, Inc." would probably never be organized, there are many instances, especially in this day of multitudinous laws, where an entrepreneur may not be aware that what he proposes to do with his corporation is a violation of a criminal statute. Examples which can be immediately thought of are a corporation to lend money at rates which are usurious,³⁹ to perform certain professional services,⁴⁰ to store or sell alcoholic liquors,⁴¹ or to supply minors with tobacco or cigarettes.⁴² This provision can place a grave responsibility upon the attorney, and should encourage him when he drafts the articles of incorporation to use language demonstrating that the incorporation is for a lawful purpose.

FILING

When the articles of incorporation are delivered for filing, there should be an executed original and one conformed copy

37. See, for example, UNIFORM SECURITIES ACT, §304(14), 1961 ACTS AND JOINT RESOLUTIONS 159, 52 STAT. AT LARGE 185, 199.

38. MODEL ACT §49.

39. S. C. CODE §8-9 (1952); *State v. Riddle*, 160 S. C. 477, 158 S. E. 833 (1931).

40. S. C. CODE §56-142 (1952) (practice of law); S. C. CODE §56-1354 (1952) (practice of medicine); other examples could be given.

41. S. C. CODE §4-33 (1952).

42. S. C. CODE §15-556 (1952).

of the articles, the original being signed by the incorporator or incorporators.⁴³

The articles must be "verified."⁴⁴ Therefore, at the conclusion of the articles, there should be a certificate signed by each person signing the document to the effect that he has read and understood the meaning and purport of the statements contained in the document, that such statements are true, or that he is informed or believes that such statements are true, and that he signed the articles.⁴⁵ It is not necessary that this certificate be signed before a notary public.

The original of the articles, along with the conformed copy, should be tendered to the Secretary of State together with all fees, and should be accompanied by the attorney's certificate. The Secretary of State will then determine whether or not the articles comply with the requirements of sections 1.4, 1.5 and 1.6, set forth the required information, and do not adopt the name of a corporation in violation of section 3.1. After making such determination, the Secretary of State will file the articles of incorporation.⁴⁶ He will return the conformed copy of the articles with his endorsement thereon for retention with the permanent records of the corporation.

BEGINNING OF CORPORATE EXISTENCE

Under the act the corporate existence of the corporation begins as of the date of filing of the articles of incorporation. In this respect the South Carolina act closely follows the Model Act and eliminates all conditions precedent and subsequent to incorporation. This elimination of conditions will, it is felt, also banish from the corporate law of this State, at least so far as the organization of corporations is concerned, the often complex and technical questions of whether or not the corporation exists at all, and, if so, is it a *de jure* or only a *de facto* one. There is nothing that can be done prior to filing which would accomplish *de facto* existence and there is nothing to be done subsequent to filing that would affect *de jure* existence.

43. S. C. CODE §12-11.4 (Supp. 1962).

44. S. C. CODE §12-14.2 (Supp. 1962).

45. S. C. CODE §12-11.5 (Supp. 1962). The draft version of the act specifically used the word "acknowledged." This was changed in the act to "verified," but apparently the same result would follow.

46. S. C. CODE §12-14.4 (Supp. 1962).

It is true that our present law has a provision⁴⁷ intended to aid in the decision as to corporate existence by providing that "no irregularity . . . shall be held to vitiate the incorporation" until suit by the state. But this section in reality only serves to remove the proceedings one step and change the question to "What is an 'irregularity'?" Or, as the court put it in *Myer v. Brunson*,⁴⁸ "Did the . . . omissions by the incorporators amount only to irregularities?" In the *Myer* case the court held that although a failure of the incorporators to comply regularly and exactly with all the provisions of the law in regard to the formation of corporations should not vitiate the charter, the legislature did not mean that the incorporators might ignore the substance of the law and escape. Although in the *Myer* case the omissions were so substantial that the Supreme Court held that there was no corporation, it is significant that the circuit judge had held that there was a *de facto* corporation. Since it is generally recognized in the field of corporate law that it is more important that the law be certain and ascertainable than that a desired result be reached, it is extremely undesirable that a state of facts could exist in this important area upon which there could be a difference of opinion as to legal result.

In this respect the new act makes a fundamental change in the corporate law theory of this state. Under the present law, the Supreme Court could correctly say:

The granting of a charter by the state does not create a corporation. It is merely permissive. It authorizes the petitioners to organize, to create, and to bring into being the corporation which the state has authorized. It devolves upon the parties themselves to form the corporation by their acts. . . .⁴⁹

Under the present law, no one can ever be certain as to exactly when a corporation became a corporation, and, more specifically, at exactly what point a creditor must look to the corporation rather than to the stockholders-to-be for payment. Under the act, however, the date of the existence of the corporation is fixed and ascertained, i.e. the date of filing by the Secretary of State. Before that date no corporation exists. After that date it does.

47. S. C. CODE §12-62 (1952).

48. 104 S. C. 84, 88 S. E. 359 (1915).

49. *Parker Peanut Co. v. Felder*, 200 S. C. 203, 20 S. E. 2d 716 (1942).

The words of the statute in this regard leave nothing to doubt. As is there stated, the fact that the articles have been filed is "conclusive evidence that all conditions required by this act to be performed by the incorporators have been complied with, that the corporation has been incorporated, and that its corporate existence has begun."⁵⁰

Of course this conclusive presumption does not apply against the state if it should institute proceedings to cancel or revoke the articles of incorporation, to enjoin a person from acting as a corporation without being duly incorporated, or to compel dissolution of the corporation. The section thus preserves the present power of the state to dissolve improperly organized corporations.⁵¹

REQUIREMENT OF CAPITAL

It is provided in section 4.6 that before it commences business, or incurs any indebtedness, a corporation must actually have received, for the issue of shares, at least \$1,000.00, of which at least \$500.00 must have been received in cash. This prohibition does not, of course, apply to any business transacted or indebtedness incurred as an incidental result of the organization of the corporation or to obtaining subscriptions or payment for its shares. Nor is this requirement a condition precedent to *de jure* existence of the corporation, as the corporate existence is already established.

The fact that failure to pay into the corporation the required capital does not affect its existence does not mean that a creditor who finds that he has traded with a fundless corporation because of business transacted in violation of this section is without a remedy. The act specifically provides that "any person (whether a promoter, incorporator, shareholder, subscriber, or director) who has participated in the transaction of business in violation of the section shall be jointly and severally liable for the debts or liabilities of the corporation arising therefrom."⁵² A director or other person who is opposed to action taken by a corporation in violation of the section will not be held personally liable if he dissented from the violation and caused his dissent to be recorded in the records of the corporation. If he was absent when the

50. S. C. CODE §12-14.5(b) (Supp. 1962).

51. S. C. CODE §12-62 (1952).

52. S. C. CODE §12-14.6 (b) (Supp. 1962).

action was taken, he can avoid personal liability by recording and filing his dissent promptly upon learning of the violation.

ORGANIZATIONAL MEETING OF DIRECTORS

At any time after the filing date of the articles, an organizational meeting of the board of directors named in the articles should be held.⁵³ The act does not require any meeting of the incorporators or of the subscribers, and the organization of the corporation to conduct its business is accomplished at this meeting of the directors. The meeting may be called by the incorporator (or by a majority of the incorporators), who is required to give to each director at least three days' notice of the meeting. The notice should state the time and place of the meeting. It does not have to be in writing, but may be given by "any usual means of communication." The required notice of the meeting may, of course, be waived by the directors.⁵⁴ The purpose of this initial meeting is to adopt by-laws of the corporation, elect officers, and to do any other or further acts necessary to complete the organization of the corporation, and to transact such other business as may come before the meeting. It is not necessary that the meeting be held in South Carolina. Failure to hold this organizational meeting does not affect *de jure* existence of the corporation.⁵⁵

CONCLUSION

Incorporation under the act, when contrasted with the present requirements, is a greatly simplified procedure. At the same time, it presents a real challenge to the lawyer by providing him an opportunity to tailor the corporation to meet the real needs of his client. It rids the law of many nagging little technicalities which have proved to be pitfalls for lawyers and clients alike in the past, while it provides scope for a lawyer to exercise his ingenuity and to produce the proper corporate organization to meet the special case. This simple, yet flexible, procedure represents a great step forward in the law of South Carolina.

53. S. C. CODE §12-14.7 (Supp. 1962).

54. S. C. CODE §12-18.9(c) (Supp. 1962).

55. Although, if the corporation never commences business, and never issues any shares, it may be voluntarily dissolved by the incorporators. S. C. CODE §12-22.1 (Supp. 1962).