CHAPTER 2

Legal Mechanics of Organizing Corporations*

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Chapter Contents

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§ 2.01 Introduction

The legal mechanics of organizing corporations encompass a variety of corporate, tax, securities and business considerations. By anticipating the special problems and situations which are likely to arise in the course of the start-up company's growth, its founders can structure the organization of the corporation to minimize future obstacles. While most state laws governing incorporation provide wide flexibility in establishing the organization of the corporation, the structure of the corporation, once formed, takes on a life of its own and is not always easy to alter. It is therefore important that the founders, in the incorporation process, consider both their short-term and long-term objectives and organize the corporation in a manner which will facilitate, rather than frustrate, the accomplishment of these objectives.

§ 2.02 Selection of Corporate Name

The name selected for the corporation should be distinctive. Generally it is preferable that the name have some relationship to the corporation's business. The corporate name may, but need not necessarily, serve also as a trademark or service mark for the products or services to be offered by the corporation.

While it may be difficult to select a name which is both distinctive and not already identified by the public with another company or product, incorporatiors should generally not resort to a generic appellation which is not descriptive or indicative of the corporation's business. While some of the best known tech companies have generic names, a generic name may make it more difficult not only to establish a distinctive identity for the corporation in the commercial and financing markets, but also to prevent others in the same field from using the same or a similar name. The use of the name of a founder should also generally be avoided to prevent problems or confusion which might result if and when such founder is no longer associated with the corporation.

Most state incorporation statutes require that the corporate name include a word or notation (such as "Corporation," "Company" or "Inc.") indicating the corporate identity of the enterprise.[1] Many states prohibit the use of certain words in the corporate name (such as "insurance," "bank" or "cooperative") unless the corporation meets certain requirements.

Once the name has been selected, it must be cleared for use in the particular state in which the corporation is to be formed. The office of the secretary of state generally has the authority to disapprove a particular name on the ground that it is the same as or similar to an existing name of a corporation organized under the laws of such state. If the name is cleared for use, it generally can be reserved by the applicant for periods ranging from 30 days to 12 months, depending on the particular state.

Once the name has been selected and reserved for use in the state of incorporation, a search should be conducted by legal counsel or a recognized search organization to determine whether the corporate name is available in the principal states in which the corporation anticipates that it will be conducting business. A conflict in another state will generally prevent the corporation from qualifying to do business in that state unless the name is changed. If there is no conflict in other states, the corporation should consider immediately qualifying to do business in those states in order to protect the name in those states. Certain states will allow foreign corporations to qualify to do business in the state under an assumed or "doing business as" name if there is a conflict with the name of the corporation incorporated in that state; the use of such an assumed name (such as the actual name of the corporation preceded by the name of its state of incorporation) generally will not interfere with the corporation's ability to conduct its business in that state.

A search should also be conducted to determine whether there is a conflicting trademark or service mark registration or application on file at the

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[1] See, e.g., 8 Del. Code Ann. § 102(a)(1).

United States Patent and Trademark Office. This search will reveal whether the corporation is likely to encounter problems in marketing its products or services under a variation of its corporate name. Although such a search is not a guarantee that the name is not being used by another company which will have prior common law rights, it will usually provide sufficient comfort to proceed with the adoption and use of the name.

After adopting its corporate name, the corporation should consider undertaking a program to protect the name as a trademark or service mark under both federal and state law, as well as the laws of foreign countries. Since a tradename as such may not be protected under federal law, the corporation should consider adopting a logo and style of presenting the name which is distinctive and which creates a commercial impression separate from the tradename. If the corporate name functions as a trademark or service mark, an application for registration in the United States Patent and Trademark Office can be filed based on actual or intended use. Registration can be applied for before the mark is actually used in connection with an interstate sale of goods or services if the applicant declares a *bona fide* intent to use the mark. Applicants have six months after the notice of allowance (subject to certain extensions that are available) to file a statement verifying that the mark has actually been used in commerce on specific goods or services.[2]

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[2] 15 U.S.C. § 1501(d) (2012).

§ 2.03 Choice of State of Incorporation

The liberalization of most state corporation statutes has reduced the advantages formerly available by incorporating under the laws of a state other than the state in which the corporation intends to conduct its principal business operations.[1] However, it is still generally advisable to incorporate under the laws of a state with a well developed body of corporate law (such as Delaware, New York or California), because legal counsel representing potential investors and business partners will be familiar with the laws of that state and it is more likely that legal issues which may confront the corporation will have been addressed by precedents in that state. Specifically, if the corporation intends to raise venture capital, it is generally best to incorporate in Delaware as most venture capitalists prefer to invest in Delaware corporations. If the corporation does not intend to raise venture capital and the corporate law of the corporation's home state is well established, it is generally in the interest of the founders to incorporate under the laws of that state because corporate filings with state authorities can be made more quickly and conveniently and this avoids the additional expense of qualifying to do business under the foreign corporation statute of the home state.

While the differences between state corporation statutes have narrowed, there remain distinctions that should be considered carefully by founders and their legal counsel before adopting the convenient course of incorporating under the laws of the home state. The following is a summary of some of the specific areas in which differences among state statutes could affect the future operation of the start-up corporation.

[1]—Consideration for Issuance of Stock

Many founders and employees desire to make payment for their shares other than in cash, for example by performing future services for the corporation or delivering a promissory note. However, many state statutes traditionally did not consider future services or notes as permissible consideration for the issuance of shares. In 2004, the Delaware General Corporation Law (the "Delaware Statute") was amended to eliminate such restrictions, and now permits the Board to determine the adequacy of consideration, including "in-hand" consideration such as future services or promissory notes.[2] The California General Corporation Law (the "California Statute"), on the other hand, takes the traditional approach and provides that future services are not valid consideration and that promissory notes are valid consideration only if they are adequately secured by collateral other than the shares acquired

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[1] See, e.g., Cary, "Federalism and Corporate Law: Reflections Upon Delaware," 83 Yale L.J. 663, 701 (1974) (describing this liberalization as a "race to the bottom"). *Cf.,* Easterbrook and Fischel, *The Economic Structure of Corporate Law* 212-227 (1991) (describing this liberalization as a "race for the top").

[2] See 8 Del. Code Ann. § 152. See also: Mass. Gen. L. Ann., Ch. 156B, § 18 (requiring that the par value of stock must be paid for by consideration other than debt or notes), Mass. Gen. L. Ann., Ch. 156D, § 6.21 (superceding Ch. 156B (in 2004), such that Massachusetts law now provides that the Board may authorize shares for consideration of any tangible or intangible property or benefit, including services performed or services to be performed).

or if they are received in connection with certain stock purchase or stock option plans.[3]

[2]—Stockholder Consents

It is often desirable or necessary to obtain stockholder approval of certain corporate actions in situations where there is not enough time to provide the requisite advance notice of a stockholder meeting to all stockholders, provided notice is subsequently given to non-participating stockholders for most non-unanimous written consent actions.[4] The Delaware Statute and the California Statute permit stockholders to take action without a meeting, without prior notice and without a vote by written consent of the holders of the minimum number of shares required under the statute to authorize such action, while the Massachusetts Statute provides that any written action of stockholders must be unanimous.[5]

[3]—Voting Agreements

Both founders and investors often desire to assure that they are represented on the Board of Directors of the corporation. This is frequently accomplished through a stockholders agreement under which certain principal stockholders agree to vote all of their shares in favor of the election of directors designated by such founders and/or investors.[6] Absent specific statutory authorization for such agreements, the common law of the state of incorporation must be reviewed to determine the enforceability of such an agreement. While the Delaware[7] and Massachusetts[8] statutes expressly authorize voting agreements that are agreed to by less than all stockholders, the law in certain other jurisdiction is less clear.

[4]—Election of Directors

Different state law voting requirements for the election of directors affect the rights of minority stockholders to either change membership of the Board of Directors or to gain representation on the Board. For example, in states such as California cumulative voting is mandatory and minority stockholders may under certain circumstances be assured of their ability to elect a representative to the Board.[9] The majority of states, however, make cumulative voting optional, and allow corporations to either opt-out of a cumulative default rule (as with Alaska) or opt-in where straight voting is the default (as with Delaware and Massachusetts) through the corporate certificate of incorporation.[10]

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[3] Cal. Corp. Code § 409(a)(1).

[4] See discussion and form at § 22.07[2] *infra*.

[5] *California:* Cal. Corp. Code § 603.
Delaware: 8 Del. Code Ann. § 228.
Massachusetts: Mass. Gen. L. Ann., Ch. 156B, § 43.

[6] See discussion and Form of Voting Agreement at § 9.06 *infra*.

[7] 8 Del. Code Ann. § 218.

[8] Mass. Gen. L. Ann., Ch. 156B, § 41A.

[9] Cal. Corp. Code § 708.

[10] See, e.g., Alaska Stat. § 10.06.420(d); 8 Del. Code Ann. § 214; Mass. Gen. L. Ann., Ch. 156D, § 7.28(b).

A classified Board of Directors consisting of members elected for staggered, multiple-year terms by a single class of voting stock may be useful in preventing a change in control following a change of stock ownership. The Delaware and Massachusetts Statutes authorize a classified Board of Directors, while the California Statute provides that directors can only be elected for annual terms.[11]

[5]—Number of Directors

Different states have different requirements as to the minimum number of directors which must comprise the Board of Directors. For example, Delaware permits the Board of Directors to consist of only one member.[12] On the other hand, the California and Massachusetts Statutes provide that the number of directors cannot be less than three, except that a corporation with only one stockholder can have one or more directors and a corporation with only two stockholders can have two or more directors.[13] If a corporation has only two founders but desires to issue shares to others, it may be desirable to incorporate in a state which would not require the founders, at least initially, to elect a third director who might represent the "swing" vote and therefore might have more influence in the corporation than the founders desire.

[6]—Appraisal

State statutes differ in the treatment of rights of appraisal granted to stockholders who dissent to the taking of certain corporate action. With appraisal rights, dissenting stockholders who follow the statutory requirements for perfecting such rights are entitled to surrender their shares in exchange for an amount equal to the fair market value thereof. In most states, fundamental transactions such as mergers and consolidations give rise to rights of appraisal.[14] In some states, such as Massachusetts, dissenting stockholders also are entitled to appraisal rights in the event of an amendment to the corporation's charter which adversely affects such stockholders.[15] To the extent the founders desire to place certain rights or obligations (such as preemptive rights or restrictions on transfer) in the charter to assure that they apply to all stockholders, the founders should consult the relevant state statute to determine whether any amendment to these rights or obligations may result in the creation of appraisal rights.

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[11] *California:* Cal. Corp. Code § 301. *Cf.,* Cal. Corp. Code § 301.5 (enabling classified boards for corporations with shares listed on the NYSE, AMEX or Nasdaq National Market System).

Delaware: 8 Del. Code Ann. § 141(d).

Massachusetts: Mass. Gen. L. Ann., Ch. 156B, § 50.

[12] 8 Del. Code Ann. § 141(b).

[13] *California:* Cal. Corp. Code § 212(a).

Massachusetts: Mass. Gen. L. Ann., Ch. 156B, § 47.

[14] The most common exception for such rights is made for public companies. See e.g.:

Delaware: 8 Del. Code Ann. § 262.

[15] Mass. Gen. L. Ann., Ch. 156B, § 76.

[7]—Call of Stockholders Meetings

The Board of Directors and management of a corporation often desire to prohibit minority stockholders from calling a special meeting of stockholders. State laws vary with respect to the right of stockholders to call meetings. For example, under the California and Massachusetts Statutes, the holders of 10 percent of the voting shares may call a special meeting.[16] On the other hand, the Delaware Statute does not provide stockholders with such default power. Instead it provides that the Board or such persons (e.g., stockholders) as may be authorized by the certificate of incorporation or bylaws may call a special meeting.[17]

[8]—Anti-Takeover Statutes

While founders of a venture rarely are concerned at the time of incorporation with the threat of an unfriendly takeover, the presence of an anti-takeover statute in the state of organization should at least be brought to the attention of the founders to avoid subsequent surprises. This is particularly true in states, such as Massachusetts, which have adopted statutes which in certain circumstances govern private purchases from certain stockholders as well as tender offers to all stockholders.[18] Consideration may also be given to the state's approach or acceptance of defensive measures, and the presence of so-called "constituency statutes" may serve as an indicator as these reflect a policy of enabling management to consider nonstockholders stakes in the enterprise, such as employees or community, within the hostile context.[19]

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[16] *California:* Cal. Corp. Code § 600(d).
Massachusetts: Mass. Gen. L. Ann., Ch. 156B, § 34.

[17] 8 Del. Code Ann. § 211(d).

[18] Mass. Gen. L. Ann., Ch. 110C, § 1.

[19] Although Delaware has no statutory analog to a constituency statute, there is ample Delaware jurisprudence supporting this perspective. See, e.g., Unocal Corporation vs. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985).

§ 2.04 Articles of Incorporation

After selecting the corporate name and state of incorporation, all that remains to create the organization as a legal entity is the completion and filing of the articles of incorporation or articles of organization (as applicable) in the appropriate state office.

Each state has its own requirements for the contents of the articles. However, these requirements generally differ more in form than in substance, and typically include the following:

[1]—Name of the Corporation

As discussed above, the name should be searched and reserved before the articles are filed.

[2]—Purposes and Powers

Many states, including Delaware and California, currently permit the articles to recite merely that the purpose of the corporation is to engage in any lawful activity for which corporations may be organized in that state.[1] Other states, such as Massachusetts, require by regulation or statute that at least one specific purpose be stated.[2] If a specific purpose is stated, it should be drafted as broadly as possible and should be accompanied by a reference to the more general purposes permitted under the state statute.

A "Powers" clause indicates the manner in which the corporation may fulfill its purposes. Most state statutes set forth the general powers that a corporation may exercise. In such states, the powers need not be enumerated in the articles and if they are, care should be taken that any deviation from the permitted statutory powers is intentional.

[3]—Authorized Capital

Generally, the aggregate number of shares which the corporation shall have authority to issue, the par value of these shares and the class or classes into which these shares may be divided must be stated in the articles. While the initial authorized capital can be changed by amendment to the articles, the founders can save expense and avoid delays in later transactions by adopting a capital structure that can easily accommodate their anticipated financing plans.

[a]—Number and Classes of Shares

Initially, the articles should authorize a number of shares of capital stock sufficient to cover not only the shares to be issued to the founders, but also

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[1] See:
California: Cal. Corp. Code § 202(b)(1).
Delaware: 8 Del. Code Ann. §§ 101(b), 102(a)(3).
[2] Mass. Gen. L. Ann., Ch. 156B, § 13(a)(3).

shares to be issued to prospective employees and investors. In considering the authorized number of shares of common stock, the founders should take into account how the minimum filing fee required by the state of incorporation is calculated and should create at least the maximum number of shares which may be authorized for the minimum filing fee.[3]

Venture capital investors generally receive preferred stock or a senior class of common stock for their investment in the corporation. The directors and management of the corporation customarily do not resist this requirement for two reasons. First, normally the investors contribute substantially more cash for their shares than the founders and therefore have legitimate business reasons for insisting upon preferential rights for their equity position. Second, it is often in the best interests of the corporation, after the venture capital financing, to continue to be able to attract key employees by offering equity participation at a per share price less than that paid by the investors. Since incentive stock options cannot be granted at less than fair market value and shares of capital stock cannot be issued to employees at less than fair market value without current income tax consequences, start-up companies ordinarily seek to maintain a relatively low fair market value for the common stock. While no one factor is conclusive in establishing the fair market value of the common stock, the existence of an outstanding class of preferred stock with meaningful preferential rights (for example, as to liquidation, dividends and redemption) serves to differentiate the value of the two classes of stock, particularly during the development stage of the enterprise before it realizes substantial revenues or earnings.

While it is important to anticipate the issuance of preferred stock to investors, it is generally not advisable to fix in advance the precise terms of the preferred stock because most sophisticated investors will negotiate their own preferences. In order to create maximum flexibility, the founders may, if permitted by the state of incorporation, authorize series or "blank check" preferred stock and empower the Board of Directors to determine, by Board resolution and without stockholder approval, the specific rights, preferences, privileges and other characteristics of each specific series of preferred stock.[4] While the availability of series preferred stock will provide the directors with flexibility in negotiating, changing and fixing the terms of any series of preferred stock, it is nevertheless necessary before the issuance of shares of such series to file with the appropriate state office a certificate containing the terms of the series. That certificate under most state statutes becomes a part of the articles of incorporation. As a result, any amendment to the terms of any outstanding series of preferred stock authorized by the Board of Directors must be implemented in accordance with the statutory requirements relating generally to all amendments to the articles of incorporation. It is therefore important in drafting the terms of any particular series of preferred stock to anticipate the creation of subsequent series (which may

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[3] For example, Delaware's filing fee and annual franchise taxes are based on the corporate capitalization. See: 8 Del. Code Ann. § 391; Del. Code Ann. §§ 501, 503(a)(1).

[4] See, e.g., 8 Del. Code Ann. § 151(c) – (d).

have junior, equal or senior rights as to liquidation, dividends, redemption, voting or other rights) and to make sure, if possible, that such subsequent series can be created without need for amending the prior series.

[b]—Par Value

Most state statutes permit the authorization of shares with or without a stated par value. Historically, the par value represented the expected selling price for the shares. As corporation law has evolved, however, the par value selected for authorized shares has generally played no significant role other than to present unintended obstacles and expense for incorporators who do not anticipate the mechanical consequences of the selection.

Generally, stock having par value may not be issued for permissible consideration worth less than the aggregate par value of the issued shares. To the extent shares are issued in consideration for property or past services, directors must act in good faith in valuing such property or services and are generally advised to obtain an independent appraisal if there is any doubt as to the value of any such property. Founders of corporations generally desire to provide for a relatively large initial capitalization (often in the single digit millions of shares) so that they can issue to themselves, and can offer to subsequent employees, a large number of shares. While it is, of course, the proportionate ownership represented by the shares, rather than the actual number of shares, which is the real measure of the stockholder's equity position in the corporation, the psychological advantages of large share ownership continue to influence founders' decisions as to the number of shares which are available for employees. The primary disadvantage in providing for the issuance of large numbers of shares is that the purchasers often do not desire to pay an amount equal to the aggregate par value of the purchased shares (especially because neither future services nor promissory notes are in most states permissible consideration for this purpose).

Most founders resolve this dilemma by compromising the number of shares they will initially receive and establishing a par value which is nominal (for example, $0001 per share). A low par value will reduce the amount of statutory consideration required to be paid by founders and employees, and will allow the corporation in some states to accept other consideration, such as promissory notes, for the balance. Also, a low par value may result in lower filing fees and annual franchise taxes in the state of incorporation and foreign states in which the corporation is qualified to do business (although in many states a par value of less than $1.00 is considered to be $1.00 for this purpose).

The primary disadvantage of low par value capital stock is that it may present difficulties in implementing a subsequent stock split without creating a par value which appears to be unusually small. There is no legal prohibition against establishing a fractional par value or a par value less than $.01 per share.

Start-up companies generally implement at least one "stock split" of their common stock before they become public companies to enable the corporation to offer shares to employees at an affordable price, or to yield a price per share which is acceptable to underwriters who generally prefer to establish initial public offering prices in the range of $10 to $20 per share.

There are two basic ways to effect a stock split. A pure stock split involves an amendment to the articles of incorporation (in most states requiring stockholder approval) which correspondingly subdivides each share into a larger number of shares and also subdivides the par value per share. As a result, the amount stated in the corporation's capital account remains the same but is divided into more shares. Alternatively, the corporation may declare a stock dividend so that each stockholder will receive additional shares of stock (with no change in the par value per share).

Generally, a stock dividend will be the simpler choice because it does not require stockholder approval of an amendment to the articles of incorporation and can be effected simply by authorization of the Board of Directors and the issuance of certificates for additional shares. However, many state statutes preclude the declaration of stock dividends except to the extent that they are paid out of capital surplus or its equivalent.[5] To the extent that the corporation's capital surplus is less than the aggregate par value of the shares to be issued as part of the stock dividend, the corporation may be left with no choice but to effect an actual stock split. This is particularly true in the case of start-up companies in the development stage, which generally operate without any capital surplus or retained earnings.

Most states also permit the creation of stock without any par value[6] and some states, such as California, place no significance on par value. The primary advantages of creating stock with no par value are that it minimizes problems of assuring that statutory consideration is paid for the shares and facilitates the implementation of stock splits. The primary disadvantage is that in most states the filing fees for the creation and increase of authorized shares of stock without par value and the franchise taxes applicable to such shares are significantly higher than for shares with a stated par value.

[4]—Name and Address of Resident Agent

Most states require that the corporation designate a resident agent in the state. If the corporation is organized under the laws of a state different from the state in which it maintains its principal office, the corporation may designate any one of a number of national service organizations which will provide this function for an annual fee. If a corporation designates an individual (such as legal counsel) as its agent, it must be sure to change the designation promptly after the individual ceases to be associated with the corporation, especially since in most states legal service of process may be made upon the corporation by service of process upon such agent.

[5]—Duration

Most state statutes permit the duration of the corporation to be perpetual. It is unusual for a corporation to specify a limited term for its existence.

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[5] See, e.g., Cal. Corp. Code § 500(a)(2) (requiring that, before a corporation can distribute dividends, the corporation's post-distribution assets must exceed its total liabilities plus the preferential rights amount).

[6] See, e.g., 8 Del. Code Ann. § 102(a)(4).

[6]—Other Permissive Provisions

Most state statutes permit the articles to include additional provisions which are not in conflict with express statutory provisions or the public policy of the state. Included in this category are provisions which relate, for example, to restrictions on transfer of securities, special votes required from certain classes of stockholders for corporate events such as mergers or acquisitions, the indemnification of officers and directors and procedures for authorizing transactions with interested parties.[7] The advantages of including such provisions in the articles are that (1) they will automatically apply to and bind all stockholders who purchase shares either from the corporation or from other stockholders, (2) they will be part of a public document and therefore perhaps more easily enforceable against creditors and other third parties, and (3) they may not be amended without compliance with statutorily prescribed procedures. The disadvantages of including such provisions in the articles are that (1) it makes it difficult to provide for differential arrangements among a single class stockholders, (2) the need to comply with statutory procedures for amendment may delay the closing of a financing or other transaction which requires such amendment, and (3) an amendment to such provisions may, as discussed above, trigger certain statutory appraisal rights under the laws of the state of incorporation.

[7]—Filing of the Articles

Once the articles are signed by the incorporators, they must be filed with the appropriate state official, generally the Secretary of State. In most jurisdictions, the corporate existence commences upon such filing. It should be noted, however, that most states provide that the filing shall be effective only after it has been approved by the filing officer. Unless an immediate effective date is specifically requested, some state offices may delay the processing of the filing. Therefore, care should be taken to determine the precise effective date so that the corporation does not convene its organizational meeting of directors or issue stock certificates before the corporate existence has commenced.

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[7] See, e.g., 8 Del. Code Ann. § 102(b).

§ 2.05 Bylaws

The bylaws of the corporation are the rules and procedures which govern the conduct of its affairs and the rights and powers of its directors, officers and stockholders.

Most legal counsel have prepared their own standard form of bylaws which are designed to comply with the laws of the state in which such counsel practices and many have a standard form of bylaws which are designed to comply with Delaware Corporate law. While these standard forms will generally be adequate to serve the start-up corporation, they should nevertheless be reviewed carefully to make sure that they are consistent with the intentions of the founders. Provisions which frequently require changes from the standard form include the following:

[1]—Meetings of Directors

It is generally desirable to establish notice requirements for meetings of directors which will provide the corporation with the maximum flexibility permitted by state law. This may be accomplished with a provision that regular meetings may be held without notice at such times as may be determined by the Board, or by allowing meetings to be called on relatively short notice and by permitting notices to be given by telex, telecopier or even telephone. However, to the extent a director resides out of the country, it may be desirable to provide for a longer notice period to make sure that such director is given a reasonable opportunity to participate in the meeting.

[2]—Voting Rights

Generally, the bylaws defer to the articles of incorporation in delineating the voting rights of the corporation's stockholders. However, to the extent that more than one class or series of stock is authorized, the incorporators should make sure that the bylaws adequately provide for the voting, quorum and notice requirements for each class or series. For example, if a separate class vote is required for certain actions, the bylaws should state whether a quorum of only that class, or all classes, is necessary for a meeting at which such vote is taken.

[3]—Officers

The bylaws generally describe the principal duties and responsibilities of the principal officers of the corporation. Often, standard form bylaws will designate the President as both the chief executive officer and chief operating officer. The offices of CEO and COO are generally not statutory designations, and care should be taken to make sure that the bylaws accurately specify the different functions of the President and the Chairman of the Board of Directors, especially if it is expected that they will be different individuals.

[4]—Indemnification

Most state corporation statutes enable corporations to indemnify their officers, directors and other persons against certain liabilities arising out

of the performance of their duties. Bylaws are generally drafted to allow for the broadest indemnification permitted by the applicable state statute. However, incorporators may desire as a matter of corporate policy to limit the indemnification provisions, particularly if such provisions provide for mandatory rather than permissive indemnification. For example, the incorporators may desire to extend mandatory indemnification to officers, directors and plan fiduciaries, but only permissive indemnification to other employees and agents of the corporation. Consideration should also be given to placing indemnification provisions in the certificate of incorporation.

[5]—Fiscal Year

Most start-up corporations do not expect to realize significant taxable income in the early years of their existence. Therefore, while the incorporators should consider whether they might realize tax savings by selecting a short first year, generally this consideration is secondary to other more general business concerns. For example, the incorporators should take into account the seasonality of the business and consider adopting a fiscal year which will end when inventories are not likely to be at their highest point. It may also be advisable to review the fiscal years adopted by others in the corporation's industry so that the corporation, once it is a public company, is reporting financial results on a comparable basis. Some founders desire to establish a fiscal year which ends prior to the end of the calendar year so that they have time to perform personal tax planning between the end of the corporation's tax year and their own tax year; however, this planning can ordinarily be undertaken during the course of the year and should not play a major role in the determination of the tax year of most corporations other than those electing Subchapter S status. If the corporation is to elect tax treatment under Subchapter S of the Internal Revenue Code, the tax year must be a year ending December 31 or any other tax year for which it establishes a business purpose to the satisfaction of the IRS.

§ 2.06 Organizational Meeting of Directors

Upon completion of the Act of Sole Incorporator,[1] the organizational meeting of the initial Board of Directors is usually held, by written consent, immediately after the corporation is formed.[2] Generally, the directors should authorize at the meeting:

(1) the actions of the sole incorporator;
(2) the adoption of the corporation's Bylaws;
(3) the election of the initial officers;
(4) the selection of the fiscal year;
(5) the selection of a specimen stock certificate for the corporation's common stock;
(6) the selection of a corporate seal;
(7) the designation of the corporation's bank or banks;
(8) the issuance of common stock to the initial stockholders; and
(9) the election under Subchapter S, if desirable.

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[1] See discussion and form at § 23.01 *infra*.

[2] See § 2.14 *infra* for sample resolutions which might be adopted by the directors at this meeting.

§ 2.07 Other Mechanical Steps

[1]—Corporate Seal

The corporate seal is generally no longer necessary to effect a binding contract, and many states specifically provide that the absence of a seal shall not affect the validity of the instrument.[1] The presence of the seal, however, may be *prima facie* evidence that the instrument is duly authorized, and many banks continue to require the seal on banking resolutions submitted by corporations.

[2]—Stock Book and Minute Book

The stock book containing stock certificates and related stubs and the minute book containing the articles of incorporation, bylaws and minutes of meetings of directors and stockholders should be prepared upon incorporation and kept in a secure place. The secretary of the corporation should maintain the originals, and a duplicate copy of the minute book should be kept at the office of legal counsel or at the corporation's offices if legal counsel serves as the secretary. It is imperative that both the stock book and minute book be kept current because it is difficult retroactively to cure problems caused by the absence of required documentation, and prospective investors and their counsel, in both private and public financings, will review these records carefully for completeness. On-line stock book and minute book services are becoming increasingly popular and, if properly used and maintained, can increase the efficiency of sharing this information.

[3]—Application for Employer Identification Number

Promptly after incorporation, the corporation must complete and submit a Form SS-4 to the Internal Revenue Service to obtain a Federal Employer Identification Number. The Internal Revenue Service website provides a convenient and expeditious means to apply for a Federal Employer Identification Number. Some states will also require a separate state employer identification registration.

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[1] Z. Cavitch, 3 *Business Organizations,* § 62.05(1) (Matthew Bender 1984).

§ 2.08 Certain Tax Considerations

Other Chapters of this book discuss the tax consequences of issuing stock as compensation for services rendered by stockholders, and the tax advantages of the special treatment available to corporations under Subchapter S and Section 1244 of the Internal Revenue Code. Certain tax considerations to be taken into account at the organizational stage include the following:

[1]—Section 351

If one or more incorporators intend to transfer assets to the corporation in exchange for stock, it may be desirable to structure the exchange so that it qualifies for tax-free treatment under Section 351 of the Internal Revenue Code. Generally, such a transfer will be tax-free if: (1) the transfer is made solely in exchange for stock of the corporation; and (2) the transferor, or transferors as a group, own, after the transfer, at least 80% of the total combined voting power of all classes of stock entitled to vote and at least 80% of the total number of shares of all other (nonvoting) classes. If any money or property is received by the transferor in addition to stock of the corporation, the transferor will be taxed on any gain to the extent of this other consideration.

In structuring the transaction to comply with Section 351, incorporators should be aware that stock rights and stock warrants do not qualify as "stock" which may be received tax-free.

In some cases, it may be advantageous to structure the transaction specifically to avoid tax-free treatment. In a tax-free incorporation, the corporation's basis in the property which it receives is equal to its basis in the hands of the transferor. If the property is worth more than its basis, the corporation may in a taxable transaction step up such basis and obtain higher depreciation or cost recovery deductions at the cost of a capital gain tax incurred by the incorporators. If the property is worth less than its basis, the transferor may seek to sell the property to the corporation and deduct the loss (unless Section 267 of the Internal Revenue Code applies which disallows the deduction of losses from sales of property between related persons).

If a transferor transfers shares of capital stock in another company to the corporation in a tax-free transaction, the transferor's basis in his shares of capital stock of the corporation is equal to his basis in the transferred shares. Thus, if a founder holds shares with a low cost basis, he can use these shares to acquire an investment in a start-up company and defer realizing a tax on the appreciation in the value of such shares until he disposes of his investment in the new company. However, the start-up corporation may be more restricted than the transferor in its ability under applicable securities laws to sell immediately any of such shares.

[2]—Thin Capitalization

Under Section 385 of the Internal Revenue Code, the IRS may examine a corporation's capitalization and determine that an arrangement described as a loan should be recharacterized as an equity investment. If this occurs, amounts deducted by the corporation as interest may be reclassified as

non-deductible dividends, and amounts treated as a tax-free repayment of a loan may be reclassified as dividends taxable at ordinary income rates. Also, bad debts might be recharacterized as worthless stock losses. It is difficult to ascertain an acceptable debt-to-equity ratio, although ratios of approximately 3-to-1 are fairly common. These ratios obviously vary according to the capital requirements of the corporation's industry, and even a 1-to-1 ratio is not immune from challenge by the IRS. Founding stockholders should also avoid advancing loans to the corporation on a proportionate basis and should attempt to establish repayment and interest terms which are equivalent to those which might apply to a third-party loan.

[3]—Organizational Expense

The costs of organizing a corporation are not immediately deductible. Under Section 248 of the Internal Revenue Code, however, a corporation may elect to amortize organizational costs over a period not less than sixty months. If such an election is not made, the capitalized costs of organizing the corporation are generally not deductible until final dissolution of the corporation. Organizational costs include legal fees incident to the organization, related accounting fees and filing fees. Expenditures incurred in connection with the sale of securities (such as commissions and placement fees) do not qualify as organizational costs.

§ 2.09 Foreign Qualification

A corporation is required to register or qualify as a foreign corporation if it is "doing business" in states other than its state of incorporation. The definition of "doing business" varies from state to state. The applicable state statutes generally include a list of activities that do not require foreign qualification rather than designating activities that do require qualification.[1]

Many states have adopted the Model Business Corporation Act or the Revised Model Business Corporation Act in one form or another. The Revised Model Business Corporation Act excludes from the definition of transacting business:

> (1) maintaining, defending or settling any proceeding;
>
> (2) holding meetings of the board of directors or shareholders or carrying on other activities concerning internal corporate affairs;
>
> (3) maintaining bank accounts;
>
> (4) maintaining offices or agencies for the transfer, exchange and registration of the corporation's own securities or maintaining trustees or depositaries with respect to those securities;
>
> (5) selling through independent contractors;
>
> (6) soliciting or obtaining orders, whether by mail or through employees or agents or otherwise, if the orders require acceptance outside of this state before they become contracts;
>
> (7) creating or acquiring indebtedness, mortgages, and security interests in real or personal property;
>
> (8) securing or collecting debts or enforcing mortgages and security interests in property securing the debts;
>
> (9) owning, without more, real or personal property;
>
> (10) conducting an isolated transaction that is completed within 30 days and that is not one in the course of repeated transactions of a like nature; or
>
> (11) transacting business in interstate commerce.[2]

The Revised Model Business Corporation Act further provides that the list is not exclusive.[3]

Once a corporation is qualified in a foreign state, it will be subject to annual franchise taxes in order to retain its qualification to do business in that state. It will also be subject to service of process and taxation in the state. An unqualified corporation may nonetheless be subject to taxation in the foreign state if there is a sufficient "nexus" between the corporation's business and the state.[4]

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[1] In California, the statue provides: "'[T]ransact intrastate business' means entering into repeated and successive transactions of its business in this state, other than interstate or foreign commerce." Cal. Corp. Code § 191(a).

[2] See Revised Model Bus. Corp. Act § 15.01(b).

[3] See Revised Model Bus. Corp. Act § 15.01(c).

[4] See Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450, 452, 79 S.Ct. 357, 3 L.Ed.2d 421 (1959) (providing that taxation by the state without a definitive link or minimum connection between the state and the corporation's

Failure to qualify as a foreign corporation where required will subject the corporation to fines, and will subject the corporation's directors, officers or agents to fines in certain states and the possibility of personal liability in some states as well. In addition, an unqualified foreign corporation may be prohibited from bringing or maintaining a court action in the state where qualification is required. As a result, a foreign corporation may be unable to enforce contracts made in the state if it does not fulfill the state qualification requirements.

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activities therein would violate due process). Congress later clarified the standard articulated in this case, 15 U.S.C. § 381(a). The Supreme Court applied the constitutional due process principle of *Northwestern States* and the statutory principles of § 381 in Wisconsin Dept. of Revenue v. William Wrigley, Jr., Co., 505 U.S. 214 (1992).

§ 2.10 "Doing Business as" and Fictitious Business Names

A corporation may be required to qualify as a foreign corporation in a state where its name is not available. In this case, the corporation must either change its name in its state of incorporation or amend its name in the foreign state so that there is no conflict in either state. A corporation may amend its name for purposes of foreign qualification by registering its original name and including a "doing business as" designation. Often, a name that is unavailable in a given state can be cleared in that state by slightly modifying the prefix or suffix of the original name or by adding the state of incorporation into the registered name itself.

If a corporation conducts business with a name that differs from the name appearing on its organizational documents, the corporation typically must file the fictitious business name on an appropriate form in each county in which it will conduct business under the fictitious name. Fictitious business names are not filed with the applicable secretary of state. Some counties also require publication of the fictitious name in a newspaper of general circulation. These filings and publications are required to ensure that consumers have access to the true name and address of the business owner.

§ 2.11 State Information Filings

Some states require corporations to file prescribed information about the corporation and its officers and directors with the secretary of state. In California, these forms must be filed within ninety days after the filing of the original articles of incorporation and annually thereafter.[1] The required information includes:

(1) The name of the corporation and the Secretary of State's file number.

(2) The names and complete business or residence addresses of its incumbent directors.

(3) The number of vacancies on the board, if any.

(4) The names and complete business or residence addresses of its chief executive officer, secretary, and chief financial officer.

(5) The street address of its principal executive office.

(6) The mailing address of the corporation, if different from the street address of its principal executive office.

(7) If the address of its principal executive office is not in this state, the street address of its principal business office in this state, if any.

(8) If the corporation chooses to receive renewal notices and any other notifications from the Secretary of State by electronic mail instead of by United States mail, the corporation shall include a valid electronic mail address for the corporation or for the corporation's designee to receive those notices.

(9) A statement of the general type of the corporation's business that constitutes the principal business activity of the corporation (for example, manufacturer of aircraft; wholesale liquor distributor; or retail department store).[2]

The California Corporation Code was amended in 2004 to provide that publicly traded companies must file additional information, including:

(1) The name of the independent auditor that prepared the most recent auditor's report on the corporation's annual financial statements.

(2) A description of other services, if any, performed for the corporation during its two most recent fiscal years and the period between the end of its most recent fiscal year and the date of the statement by the foregoing independent auditor, by its parent corporation, or by a subsidiary or corporate affiliate of the independent auditor or its parent corporation.

(3) The name of the independent auditor employed by the corporation on the date of the statement, if different from the independent auditor listed pursuant to paragraph (1).

(4) The compensation for the most recent fiscal year of the corporation paid to each member of the board of directors and paid to each of the five most highly compensated executive officers of the corporation who

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[1] See Cal. Corp. Code § 1502(a).

[2] See Cal. Corp. Code § 1502(a). With respect to foreign corporations in California, see Cal. Corp. Code § 2117(a).

are not members of the board of directors, including the number of any shares issued, options for shares granted, and similar equity-based compensation granted to each of those persons. If the chief executive officer is not among the five most highly compensated executive officers of the corporation, the compensation paid to the chief executive officer shall also be included.

(5) A description of any loan, including the amount and terms of the loan, made to any member of the board of directors by the corporation during the corporation's two most recent fiscal years at an interest rate lower than the interest rate available from unaffiliated commercial lenders generally to a similarly-situated borrower.

(6) A statement indicating whether an order for relief has been entered in a bankruptcy case with respect to the corporation, its executive officers, or members of the board of directors within the previous ten years; of the corporation during the 10 years preceding the date of the statement.

(7) A statement indicating whether any member of the board of directors or executive officer of the corporation was convicted of fraud during the 10 years preceding the date of the statement, if the conviction has not been overturned or expunged.

(8) A description of any material pending legal proceedings, other than ordinary routine litigation incidental to the business, to which the corporation or any of its subsidiaries is a party or of which any of their property is the subject, as specified by Item 103 of Regulation S-K of the Securities Exchange Commission (Section 229.103 of Title 12 of the Code of Federal Regulations1). A description of any material legal proceeding during which the corporation was found legally liable by entry of a final judgment or final order that was not overturned on appeal during the five years preceding the date of the statement.[3]

The required information may be broader than the analogous federal security laws. All of the information is available for public inspection.

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[3] See: Cal. Corp. Code §§ 1502(a)(2) and 2117(a)(2).

§ 2.12 Reports to Shareholders

Some states require corporations to provide reports to their shareholders. In California, the board is required to send an annual report to the shareholders no later than 120 days after the end of the fiscal year unless the corporation has fewer than 100 shareholders of record and the requirement is expressly waived in the corporation's bylaws.[1] The report must contain a balance sheet as of the end of the fiscal year and an income statement and statement of changes in financial position for that year, accompanied by any report thereon from the corporation's independent accountants. If there is no such report, a certificate from an authorized officer must be included providing that the statements were prepared without audit from the books and records of the corporation.[2] Additional information is required for corporations with more than 100 shareholders that are not subject to the periodic reporting requirements of the Securities Exchange Act of 1934.[3] Where applicable, the report must be sent to the shareholders at least fifteen days prior to the annual meeting of shareholders to be held during the next fiscal year.[4] Delaware corporations are not subject to these annual reporting requirements in Delaware.[5]

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[1] See Cal. Corp. Code § 1501(a)(1).

[2] *Id*.

[3] See Cal. Corp. Code § 1501(b).

[4] See Cal. Corp. Code § 1501(a)(2).

[5] However, Delaware corporations may be subject to this requirement nonetheless as a foreign corporation in California. See Cal. Corp. Code § 2115(b).

§ 2.13 Other Agreements

Most venture capital investors will insist that founders and key employees enter into the following agreements with the corporation: (1) an invention and nondisclosure agreement that requires the employee to assign inventions and discoveries to the corporation and to maintain the confidentiality of proprietary information of the corporation; (2) a noncompete agreement that prohibits the employee from competing with the corporation both during his employment and for a specified number of years thereafter (subject to applicable state law);[1] and (3) a stock restriction agreement that provides for the "vesting" of the employee's shares over a specified number of years and grants to the corporation the right to purchase all unvested shares upon the termination of employment.

Invention and nondisclosure agreements should in all cases be signed upon incorporation. Founders frequently defer consideration of noncompete and stock restriction agreements until the time of the company's initial financing and then are required to enter into difficult negotiations as to the terms offered by the investors participating in that financing. An alternative approach is to consider and implement these agreements at the time of the incorporation. Founders taking this approach will have more flexibility in structuring these agreements to meet their own individual and corporate objectives.

Factors to consider when preparing the noncompete agreement include:

(1) the length of the noncompete period;

(2) the definition of the business with which the employee will be prohibited from competing;

(3) the geographic scope of the noncompete obligation;

(4) whether the noncompete obligation will apply if the employee is terminated without cause and whether the term "cause" is defined to include subjective determinations as to job performance;

(5) whether, and under what circumstances, the employee will be compensated by the corporation during the noncompete period; and

(6) whether the agreement will continue in effect if and when the company is acquired.

Factors to consider when preparing a stock restriction agreement include:

(1) the period during which the shares of capital stock issued to the employee will vest and the frequency with which such vesting will occur (e.g., monthly, quarterly, annually, etc.) and the alignment of the founder's expected contributions to this vesting schedule;

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[1] In California, for example, noncompetes are enforceable in only very limited circumstances. *Compare* Cal. Bus. & Prof. Code § 16600 (declaring void all contracts restraining participation in commerce, including employee noncompetition agreements) with, e.g., La. Stat. Ann. § 23:921 (enforcing employee noncompetition agreements for up to two years if they meet statutory requirements).

(2) whether the employee will be entitled to immediate full vesting in the event he is terminated by the corporation without cause or if he dies or becomes disabled;

(3) whether the shares will be held in escrow by a third party until they become vested;

(4) whether the employee will be permitted to transfer unvested shares (for example, to relatives or trusts which agree to be bound by the terms of the agreement);

(5) whether the shares subject to the agreement will become fully vested in the event of an initial public offering or an acquisition; and

(6) whether the corporation shall have the right to assign to another party its right to purchase unvested shares upon the termination of the employee's employment.[2]

In considering these and other issues at the time of incorporation, the founders must take into account not only their own individual concerns, but also the needs of the corporate entity. While the conflict between these individual and corporate requirements is often difficult to discern and even more difficult to reconcile (especially if the founders and the corporation are not separately represented by legal counsel), the founders will in the long run benefit neither themselves nor their corporation if they resolve all of such conflicts to the detriment of the corporation. In fact, in structuring these agreements, the founders are likely to be confronted for the first time with the realization that the corporation which they have organized has a life of its own that requires protection and guidance.

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[2] See generally, § 9.06 *infra*.

§ 2.14 *Form:* Sample Organizational Resolutions

[Company Name]

Action of Directors
in Lieu of A First Meeting

The undersigned, being all of the members of the Board of Directors (the "**Board**") of [_____], a [_____] corporation (the "**Corporation**"), and acting in accordance with [_____] of the [_____] Corporation Law, hereby consent to the adoption of the following resolutions:

Bylaws and Appointment of Initial Directors

RESOLVED: That the adoption of the Bylaws of the Corporation, the establishment of the number of directors that constitute the full Board and the appointment of the initial directors of the Corporation by the sole incorporator of the Corporation be, and they hereby are, ratified and confirmed.

Election of Officers

RESOLVED: That the following persons be, and each of them hereby is, elected to the offices of the Corporation set forth opposite their respective names, each to serve, subject to the Bylaws of the Corporation, until his or her successor is elected and qualified or until his or her earlier death, resignation or removal:

President:	[_____]
Treasurer:	[_____]
Secretary:	[_____]

Management Powers

RESOLVED: That the President, any Vice President, the Treasurer, any Assistant Treasurer, the Secretary and any Assistant Secretary of the Corporation (collectively, the "**Proper Officers**") be, and each of them hereby is, authorized to sign and execute in the name and on behalf of the Corporation all applications, contracts, leases and other deeds and documents or instruments in writing of whatsoever nature that may be required in the ordinary course of business of the Corporation and that may be necessary to secure for operation of the corporate affairs, governmental permits and licenses for, and incidental to, the lawful operations of the business of the Corporation, and to do such acts and things as such officers deem necessary or advisable to fulfill such legal requirements as are applicable to the Corporation and its business.

Foreign Qualification

RESOLVED: That for the purpose of authorizing the Corporation to do business in any state, territory or dependence of the United States or any province of Canada or any foreign country in which it is necessary or expedient for the Corporation to transact business, the Proper Officers be, and each of them acting singly hereby is, authorized, in the name and on behalf of the Corporation, to execute and deliver such documents, and to take such actions, as the officer so acting deems necessary or appropriate to qualify the Corporation to do business in such jurisdiction; to appoint all necessary agents or attorneys for service of process and to substitute new agents or attorneys for such purpose; to designate the location of all necessary statutory offices and to change the location thereof; to make and file all necessary certificates, reports, powers of attorney and other instruments, under the corporate seal, as may be required by the laws of such state, territory, dependency, province or country to qualify the Corporation to do business as a foreign corporation therein; and, whenever it is expedient for the Corporation to cease doing business therein and withdraw therefrom, to revoke any appointment of agent or attorney for service of process, and to file such certificates, reports, revocation of appointment, surrender of authority or other instrument as may be necessary to terminate the authority of the Corporation to do business as a foreign corporation therein.

Fiscal Year

RESOLVED: That the fiscal year of the Corporation shall end on [December 31] of each year.

S-Corporation Election

RESOLVED: That the Proper Officers be, and each of them acting singly hereby is, authorized, in the name and on behalf of the Corporation, to prepare and file on behalf of the Corporation United States Treasury Department Form 2553, together with such other consents and documents as shall be necessary or appropriate to reflect the election by the Corporation under Subchapter S of the Internal Revenue Code of 1986, as amended (the "**Code**"), and corresponding state statutes, and to take such other action as any such officer may deem necessary or appropriate to qualify the Corporation under Subchapter S of the Code and corresponding state statutes.][1]

[1] If the Company is an S-Corporation, each stockholder should sign the Shareholder Agreement. The Company must file Form SS-4 (indicating 1120S for type of entity) and IRS Form 2553.

Principal Office

RESOLVED: That an office of the Corporation be established and maintained at [_____].

Stock Certificates

RESOLVED: That the Proper Officers be, and each acting singly hereby is, authorized and directed to adopt a form of stock certificate representing shares of common stock, $0.0001 par value per share, of the Corporation (the "**Common Stock**") and that the Proper Officers be, and each acting singly hereby is, directed to certify the form of certificate representing the Common Stock to any party who may so request and to insert such form in the minute book of the Corporation following these resolutions.

Corporate Seal

RESOLVED: That the Secretary of the Corporation is authorized to adopt the corporate seal of the Corporation and to affix an impression of such seal in the margin of any application, contract, lease, deed, document or instrument to which the Corporation is a party or signatory.

Banking

RESOLVED: That the President and Treasurer are each authorized:

(a) to designate such bank or banks as depositories (the "**Depository**" or "**Depositories**") for funds of the Corporation as such officer may deem necessary or advisable;
(b) to open, keep and close general and special bank accounts and safe deposit boxes with any Depository;
(c) to cause to be deposited in accounts with any Depository from time to time such funds of the Corporation as such officer may deem necessary or advisable;
(d) to designate from time to time officers and agents of the Corporation authorized to sign or countersign checks, drafts or other orders for the payment of money issued in the name of the Corporation against any such account; and
(e) to make such general and special rules and regulations with respect to such accounts (including without limitation authorization for use of facsimile signatures) as such officer may deem necessary or advisable.

FURTHER
RESOLVED: That, if any Depository requires a prescribed form of preamble, preambles, resolution or resolutions relating to such accounts or to any application, statement, instrument or other documents connected therewith, each such preamble or resolution shall be deemed to be adopted by the Board, and the Secretary or any Assistant Secretary of the Corporation is authorized to certify the adoption of any such preamble or resolution as though it were presented to the Board at the time of adopting this resolution, and to insert all such preambles and resolutions in the minute book of the Corporation immediately following this resolution.

Fair Market Value

RESOLVED: That based upon an analysis of all relevant factors deemed appropriate and applicable to the Corporation by the Board, including the market value of stock or other equity interests in companies at a similar stage as the Corporation, the risks of the financial performance of companies at a similar stage as the Corporation, and other relevant factors such as discounts for lack of marketability, the Board hereby determines that $0.0001 per share represents the fair market value of a share of Common Stock as of the date hereof.

Grant of Restricted Stock

RESOLVED: That, subject to the execution of Restricted Stock Agreements (as defined below), the Proper Officers be, and each of them acting singly hereby is, authorized on behalf of and in the name of the Corporation to issue and sell shares of Common Stock to the persons listed below, in the amounts and for the consideration set forth opposite their respective names, at a price per share of $0.0001; and that the Proper Officers be, and each of them acting singly hereby is, authorized to issue and deliver to each of such persons certificates for such shares upon receipt of payment therefor:

Name	State of Residence	Number of Shares	Consideration
[_____]	[_____]	[_____]	[_____]
[_____]	[_____]	[_____]	[_____]
[_____]	[_____]	[_____]	[_____]
Total		[_____]	[_____]

FURTHER
RESOLVED: That the Corporation be and hereby is authorized to enter into and perform its obligations under Restricted Stock Agreements by and between the Corporation and each of the individuals set forth above, substantially in the form attached hereto as Exhibit A (the "**Restricted Stock Agreements**"); and that the shares subject to such Restricted Stock Agreements shall vest as set forth in such Restricted Stock Agreements.

FURTHER
RESOLVED: That the shares of Common Stock authorized to be sold and issued by the Corporation shall be offered and sold in accordance with the terms of exemption from qualification provided by Section 25102(f) of the California Corporations Code.

FURTHER
RESOLVED: That the Proper Officers be, and each of them acting singly hereby is, authorized and directed, for and on behalf of the Corporation, to execute a form of notice of such issuance and to cause such notice, when duly executed, to be filed with the Commissioner of the California Department of Business Oversight.]

Adoption of Stock Incentive Plan and Form Agreements

RESOLVED: That the Corporation hereby adopts the 20[____] Stock Incentive Plan (the "**Plan**"), in substantially the form attached hereto as Exhibit B, pursuant to which the Corporation may grant incentive stock options, non-statutory stock options, and other stock awards for the purchase of an aggregate of [_____] shares of Common Stock.

FURTHER
RESOLVED: That the Board recommends to the stockholders that the Plan be approved; and that the Proper Officers hereby are, and each of them acting singly hereby is, authorized and directed, on behalf of the Corporation, to prepare and solicit from the stockholders of the Corporation a written consent approving the Plan.

FURTHER
RESOLVED: That the Corporation hereby reserves for issuance under and pursuant to the Plan [_____] shares of Common Stock (subject to adjustment as provided in the Plan).

FURTHER RESOLVED: That the form of incentive stock option agreement, attached hereto as Exhibit C, providing for the grant of incentive stock options under the Plan, is hereby approved.

FURTHER RESOLVED: That the form of non-statutory stock option agreement, attached hereto as Exhibit D, providing for the grant of non-statutory stock options under the Plan, is hereby approved.

FURTHER RESOLVED: That the form of restricted stock agreement, attached hereto as Exhibit E, providing for the grant of restricted stock under the Plan, is hereby approved.

Ratification

RESOLVED: That all prior acts done on behalf of the Corporation by the sole incorporator or the sole incorporator's agents be, and the same hereby are, ratified and approved as acts of the Corporation.

General

RESOLVED: That the Proper Officers be, and each of them acting singly hereby is, authorized and directed, on behalf and in the name of the Corporation, to make such filings and applications, to execute and deliver such documents, agreements and instruments, to obtain such licenses, authorizations and permits as are necessary or desirable for the Corporation's business, and to fulfill such legal requirements as are applicable to the Corporation and its business, and to take such actions as the Proper Officer so acting shall determine, in his or her sole discretion, to be necessary, appropriate or desirable to effectuate the foregoing resolutions, and that the execution and delivery of such documents, agreements and instruments and the taking of such actions by such Proper Officer shall be conclusive evidence of his or her determination and approval and of the due authorization and approval of the Board.

[Remainder of Page Intentionally Left Blank]

This Action of Directors may be executed in one or more counterparts, each of which shall be deemed an original, and such counterparts together shall constitute one and the same instrument. This Action of Directors shall be filed with the minutes of the proceedings of the Board of Directors of the Corporation.

IN WITNESS WHEREOF, the undersigned have executed this Action of Directors as of the dates set forth below.

Dated: _____ _____

[Name]

Dated: _____ _____

[Name]

Dated: _____ _____

[Name]