The Importance of Corporate Compliance

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By Leonard D. DuBoff <lduboff@dubofflaw.com>

A fundamental policy set forth by this nation’s founders and established within the legal system we have developed is the encouragement of commercial activity. Commercial activity benefits all since it provides rewards for those who provide goods and services, while the fruits of those activities are made available to consumers. In fact, any activities that unreasonably restrain trade are discouraged and, in most instances, deemed unlawful.

The policy of encouraging commercial activity is clearly demonstrated throughout the Constitution, which has sections dealing with the protection of interstate commerce, as well as providing incentives to those who develop scientific innovations and foster the commercial arts and the like.

The vehicle provided by the law for carrying on commercial activity — the business entity — is recognized as a hypothetical legal “person.” Thus, in most situations, so long as the required statutory formalities are complied with, a corporation, limited liability company, limited liability partnership or business trust may enjoy the privilege of limiting the liability of the entity to that entity, insulating the business owner her/himself from personal liability.

If, on the other hand, the business owner does not comply with the rules, regulations and laws governing the entity, then the legal system will not accord the entity status as a separate legal person.

It is for this reason that anyone who conducts business through a legal entity, such as a corporation, LLC or the like, must be careful to have the organization properly created and funded and respect the requirement to use its resources for its commercial activities and not for the personal gain of the owners. Likewise, the owners must be careful not to commingle their assets with those of the business entity. In fact, if financial matters between owners and the
entities they own are so interwoven that they must be unraveled in order to determine what resources each party has available, then a court will customarily take the position that it will not accord these parties any more of a separate existence than they have accorded themselves, and no limitation of liability will be available.

Courts also customarily take the position that business owners must adhere to corporate formalities, which are memorialized in the form of corporate records, including such documents as articles, bylaws, operating agreements and annual and special meeting minutes.

Thus, if the entity is not properly created and organized, and if those actions are not memorialized in corporate-record form, then there is a significant risk that a court will not consider the business owner to have been conducting a business as an entity separate from her/himself. Additionally, since the law generally provides that two or more persons who engage in a business for profit do so as partners and the Uniform Partnership Act makes it clear that partners have full personal liability for the contracts and wrongful acts of their copartners, there is a very strong likelihood of having a court declare noncompliant owners to be partners and, thus, personally liable for the business’s activities.

Most states require business entities to file annual reports with the corporation division of the Secretary of State or some other state regulatory agency. The purpose of such reports is to provide the state with notice that the entity remains viable and active. If the report is not filed, the agency administratively dissolves the noncomplying organization — and all of the benefits accorded a business entity will thus be removed.

Most states provide a safety net whereby the entity may be reinstated within a proscribed period, usually one year, if the appropriate filing is made. However, this reinstatement may not be deemed to retroactively reinstate the entity for all purposes.

There is a host of cases considering the issue of liability and the effect of a timely reinstatement of a business organization that has been administratively dissolved. The vast majority of those cases take the position that complying with the statute within the time specified by the law — in other words, reinstating the administratively dissolved organization — will be effective to protect the owners from personal liability or problems which occurred during the period of administrative dissolution.

This rule of nunc pro tunc reinstatement is not universal, however, and there are some cases that have penalized the business owners for their carelessness. A fairly recent patent infringement case, Paradise Creations v U. V. Sales, Inc., concerned a plaintiff who filed suit for patent infringement at a time when it was administratively dissolved for failure to file its annual report with the Florida Secretary of State. When this procedural defect was brought to its attention by the defendant making a motion to dismiss the case for lack of standing, the plaintiff promptly complied with the corporate law and the plaintiff corporation was reinstated. The state statute made it clear that the reinstatement was retroactive to the date of administrative dissolution.
dissolution.

Notwithstanding this fact, the United States Court of Appeals for the Federal Circuit held that the case must be dismissed for lack of standing. The fact that the corporation had been administratively dissolved when the case was filed meant that it did not have the right to file the lawsuit at the time it did so. The court held that the lack of standing could not be cured by complying with the state corporate law after the defective filing. The court went on to suggest that the plaintiff could refile its lawsuit now that it was in compliance.

Despite this fact, there might be some more than annoying consequences of having the case dismissed. The statute of limitations for patent infringement is six years, and while the refiled case would be effective as of the date of refiling, if the statute of limitations had already run, the claims may have become time barred. In addition, under patent law, the plaintiff can recover damages only for infringements that occur within six years of the date the case is filed. Thus, even if the claim were not time barred, the recovery might be limited to the six-year period preceding the late filing.

It is not clear from this case whether the results might have been even more problematic if the defendant had waited until the period specified in the state statute for reinstating an administratively dissolved corporation had expired. State law provides that in that event the business entity may not be retroactively reinstated. It is unclear whether the federal patent infringement case could, in fact, be refiled once a new corporation was created. Even if this were possible, it is unlikely that the plaintiff could recover infringement damages sustained by the preexisting business entity that was administratively dissolved and not properly reinstated. The recovery might, therefore, be limited to those infringing acts which occurred after the new entity was created.

It is also not clear whether this doctrine would apply to other forms of intellectual property protection governed by the federal law, such as copyright. However, policy considerations would certainly seem to favor expansion of this doctrine into all forms of federally-protected intellectual property and should thus promote maintaining the status of a business as a legal entity.

As the above cases point out, those who seek to take advantage of the law’s protection accorded to business entities must comply with the law’s requirements for creating and administering the entity. A business owner must maintain her/his business’s status as a legal entity in order to obtain the protections offered to that entity by the laws and regulations of our state and federal governments. By working with a knowledgeable and experienced business attorney, you should be able to comply with the law as it exists and evolves. Since the law is a continuum, it is necessary to monitor the changes and keep pace with the rules as they evolve.

A law office that handles corporate matters can assist clients in determining which form of business entity will best serve their needs, how to properly structure their entities to comply with the business persons’ requirements, and what ongoing steps are necessary to remain in
compliance. Your corporate counsel should regularly remind you, as a corporate client, of the necessity to have annual meetings, timely comply with the state’s filing requirements, and when and how to otherwise respond to legal issues as they arise.

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