

FORMING, FINANCING, OPERATING AND DISSOLVING A TENNESSEE CORPORATION

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I. INTRODUCTION

The corporate law that primarily governs the formation and operation of all Tennessee corporations is the Tennessee Business Corporation Act, as amended. It is codified in the sections 48-11-101 through 48-27-103 of the Tennessee Code Annotated. In this article, the Tennessee Business Corporation Act will be referenced as the "TBCA" or, simply, the "Act."

The TBCA was enacted in 1986 and became effective on January 1, 1988.¹ It significantly overhauled and simplified the earlier corporate act, the Tennessee General Corporation Act. The Act is largely modeled after the Revised Model Business Corporation Act (the "RMBCA") adopted by the Committee on Corporate Laws of the Business Law Section of the American Bar Association in 1984. Thus, much of the TBCA's language mirrors that of the RMBCA. At least nine other states, including neighboring states Arkansas, Georgia, Kentucky, Mississippi and Virginia, have also adopted versions of the RMBCA.

The premier body of corporate law in the United States is the Delaware General Corporate Law (the "DGCL"). While the TBCA contains many of the same substantive provisions as the DGCL, the TBCA has the advantages of being simpler

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¹ 1986 Tenn. Pub. Acts 887 (Portions of the TBCA have since been amended; the last significant amendments occurred in 1993).

and more cohesive. On the other hand, Delaware enjoys the advantages of well-established judicial interpretations of the DGCL and a judiciary and bar accustomed to dealing with complex corporate law issues.

II. INCORPORATION

A. Commencement of Existence

Corporate existence begins when the Charter is filed with the Secretary of State of the State of Tennessee, unless the Charter specifies a later date, but no later than ninety days after filing.² A fee of \$100 must accompany the filing of the Charter with the Secretary of State.³

Note that the Charter (and any amendments or restatements thereto) must also be filed with the Register of Deeds for the county in which the corporation's principal office is located.⁴ There may be a filing fee of \$5 plus fifty cents per page in excess of five pages.⁵

B. The Charter⁶

The charter is filed by one or more incorporators,⁷ and must include the following:⁸

1. Name of the corporation;⁹
2. Number of authorized shares of at least one class of shares;
3. Name of the initial registered agent;

² TENN. CODE ANN. §§ 48-11-304(b), 48-12-103 (2004).

³ TENN. CODE ANN. § 48-11-303(a) (2004).

⁴ TENN. CODE ANN. § 48-11-303(d) (2004).

⁵ *Id.*

⁶ The Tennessee Secretary of State's Website has many helpful forms. A charter form can be located by visiting <http://www.state.tn.us/sos/profit.htm> and clicking on the link that says, "Charter."

⁷ TENN. CODE ANN. § 48-12-101 (2004).

⁸ TENN. CODE ANN. § 48-12-102 (2004).

⁹ There are many restrictions regarding names of corporations. *See infra* Part II.E.

4. Street address, zip code, and county of the initial registered office;
5. Name, street address, and zip code of each Incorporator;
6. Street address and zip code of the initial principal office;
7. If more than one class of shares is authorized, a description of a distinguishing designation for each class. Prior to issuance of more than a single class of shares, the Charter must describe the “preferences, limitations, and relative rights of that class”;¹⁰
8. Statement that the corporation is for profit.

A corporation may include numerous other provisions in its charter. The statute specifies certain optional provisions.¹¹ In addition, Ronald Gillman has identified optional charter provisions;¹² the optional features are as follows:

1. Name and address of the initial directors;¹³
2. Purpose for which the corporation is organized;¹⁴
3. Provisions regarding the management of the business and regulating the affairs of the corporation;¹⁵
4. Provisions defining, limiting and regulating the powers and rights of the corporation, its board of directors, and shareholders;¹⁶

¹⁰ TENN. CODE ANN. § 48-16-101 (2004).

¹¹ TENN. CODE ANN. § 48-12-102(b) (2004).

¹² RONALD LEE GILMAN, TENNESSEE CORPORATIONS, 13-5, 13-6 (1st ed. Supp. 2001). Subsequent amendments to the TBCA have slightly affected Gillman’s original list, and these changes are reflected in the article.

¹³ TENN. CODE ANN. § 48-12-102(b)(1) (2004).

¹⁴ TENN. CODE ANN. § 48-12-102(b)(2)(A) (2004).

¹⁵ TENN. CODE ANN. § 48-12-102(b)(2)(B) (2004).

¹⁶ TENN. CODE ANN. § 48-12-102(b)(2)(C) (2004).

5. Provisions eliminating or limiting the personal liability of a director for monetary damages for breach of fiduciary duty, subject to certain exceptions set forth in section 48-12-102(b)(3);
6. Provisions that are required or permitted by the Act to be set forth in the bylaws;¹⁷
7. Provision eliminating the option to give oral notice of actions that require notice;¹⁸
8. Provision delaying the effective date of the Charter for up to ninety days after filing with the Secretary of State;¹⁹
9. Provision prohibiting the board of directors from adopting “emergency bylaws”;²⁰
10. Provision limiting the purpose(s) of the corporation;²¹
11. Provision limiting perpetual existence and prescribing or limiting the powers of the corporation;²²
12. Provision that restricts authority to issue stock dividends;²³
13. Provision reserving to the shareholders, instead of board of directors, authority to issue shares;²⁴
14. Provision restricting the authority of directors to grant rights, options, or warrants to acquire shares;²⁵

¹⁷ TENN. CODE ANN. § 48-12-102(b)(4) (2004).

¹⁸ TENN. CODE ANN. § 48-11-202(a) (2004).

¹⁹ TENN. CODE ANN. § 48-11-304(b) (2004).

²⁰ TENN. CODE ANN. § 48-12-107(a) (2004).

²¹ TENN. CODE ANN. § 48-13-101(a) (2004).

²² TENN. CODE ANN. § 48-13-102 (2004).

²³ TENN. CODE ANN. § 48-16-204(a) (2004).

²⁴ TENN. CODE ANN. § 48-16-202 (2004).

²⁵ TENN. CODE ANN. § 48-16-205(a) (2004).

15. Provision imposing restrictions on the transfer or registration of transferred shares;²⁶
16. Provision granting preemptive rights to shareholders;²⁷
17. Provision modifying shareholder quorum and voting requirements;²⁸
18. Provision authorizing cumulative voting for directors;²⁹
19. Provision eliminating the board of directors if less than fifty-one shareholders;³⁰
20. Provision prescribing qualifications for directors;³¹
21. Provision that specifying the number of directors;³²
22. Provisions empowering the board of directors to fix or change the number of directors;³³
23. Provision establishing a variable range for the size of the board of directors by fixing a minimum and maximum number;³⁴
24. Provision authorizing the board of directors to change the range for the size of the board or change from a fixed to a variable-range size board;³⁵

²⁶ TENN. CODE ANN. § 48-16-208(a) (2004).

²⁷ TENN. CODE ANN. § 48-16-301(a) (2004).

²⁸ TENN. CODE ANN. §§ 48-17-206(a), 48-17-208(a) (2004).

²⁹ TENN. CODE ANN. § 48-17-209 (2004).

³⁰ TENN. CODE ANN. § 48-18-101(c) (2004).

³¹ TENN. CODE ANN. § 48-18-102 (2004).

³² TENN. CODE ANN. § 48-18-103(a) (2004).

³³ TENN. CODE ANN. § 48-18-103(b) (2004).

³⁴ TENN. CODE ANN. § 48-18-103(c) (2004).

³⁵ *Id.*

25. Provision providing for shareholder election of directors by class voting;³⁶
26. Provision specifying terms for directors of not less than one nor more than three years;³⁷
27. Provision staggering terms for directors;³⁸
28. Provisions limiting removal of directors by shareholders to removal for cause;³⁹
29. Provision allowing for removal of a director for cause by a vote of a majority of the entire board;⁴⁰
30. Provision limiting authority of the board of directors to fill a director vacancy;⁴¹
31. Provision limiting the authority of the board to fix compensation of directors;⁴²
32. Provision prohibiting the board of directors from conducting a telephonic conference meeting;⁴³
33. Provision requiring unanimous written consent for the board of directors to take action without a meeting;⁴⁴

³⁶ TENN. CODE ANN. § 48-18-104 (2004).

³⁷ TENN. CODE ANN. § 48-18-105(b) (2004).

³⁸ TENN. CODE ANN. § 48-18-106 (2004).

³⁹ TENN. CODE ANN. § 48-18-108(a) (2004).

⁴⁰ TENN. CODE ANN. § 48-18-108(d) (2004).

⁴¹ TENN. CODE ANN. § 48-18-110(a) (2004).

⁴² TENN. CODE ANN. § 48-18-111 (2004).

⁴³ TENN. CODE ANN. § 48-18-201(b) (2004).

⁴⁴ TENN. CODE ANN. § 48-18-202(a) (2004).

34. Provision requiring notice of regular meetings of the board of directors;⁴⁵
35. Provision specifying the period of notice required prior to special meetings of the board;⁴⁶
36. Provision increasing the quorum requirements for the board of directors;⁴⁷
37. Provision prohibiting the board of directors from creating committees⁴⁸
38. Provision authorizing committees to exercise only authority specified by the board directors;⁴⁹
39. Provision limiting the corporation's obligation to indemnify a director who is successful in defending litigation;⁵⁰
40. Provision prohibiting directors from seeking mandatory or permissive indemnification;⁵¹
41. Provision limiting or prohibiting mandatory or permissive indemnification for officers;⁵²
42. Provision prohibiting the board of directors from adopting one or more charter amendments specified in section 48-20-102;
43. Provision limiting the authority of board of directors to amend or repeal bylaws;⁵³

⁴⁵ TENN. CODE ANN. § 48-18-203(a) (2004).

⁴⁶ TENN. CODE ANN. § 48-18-203(b) (2004).

⁴⁷ TENN. CODE ANN. § 48-18-205(a) (2004).

⁴⁸ TENN. CODE ANN. § 48-18-206(a) (2004).

⁴⁹ TENN. CODE ANN. § 48-18-206(d) (2004).

⁵⁰ TENN. CODE ANN. § 48-18-503 (2004).

⁵¹ TENN. CODE ANN. § 48-18-505 (2004).

⁵² TENN. CODE ANN. § 48-18-507 (2004).

44. Provision authorizing shareholders to adopt or amend a bylaw that sets a higher quorum or voting requirement for shareholders than as otherwise statutorily required;⁵⁴
45. Provision describing additional corporate actions subject to the shareholder's right to dissent and obtain payment of fair value;⁵⁵
46. Provision reserving to the shareholders, instead of to the board of directors, the authority to issue shares;⁵⁶ and
47. Provision establishing a par value for the classes of stock.⁵⁷

C. Organizational Meeting

After incorporation, the initial directors named in the charter must hold an organizational meeting.⁵⁸ If the charter does not name initial directors, the incorporators must hold the meeting.⁵⁹ At a directors' meeting, directors must complete the organization of the corporation by appointing officers and adopting bylaws.⁶⁰ At an incorporators' meeting, incorporators must elect directors and complete the organization of the corporation or elect a board of directors who will complete the organization of the corporation.⁶¹

Any action that the incorporators are required or permitted to take at an organizational meeting may be taken without a meeting.⁶² All incorporators must consent to taking such action without a meeting, but the vote on the action itself

⁵³ TENN. CODE ANN. § 48-20-201(a)(1) (2004).

⁵⁴ TENN. CODE ANN. § 48-20-202(a) (2004).

⁵⁵ TENN. CODE ANN. § 48-23-102(a)(5) (2004).

⁵⁶ TENN. CODE ANN. § 48-16-202 (2004).

⁵⁷ TENN. CODE ANN. § 48-16-101(c)(5) (2004).

⁵⁸ TENN. CODE ANN. § 48-12-105(a)(1) (2004).

⁵⁹ TENN. CODE ANN. § 48-12-105(a)(2) (2004).

⁶⁰ TENN. CODE ANN. § 48-12-105(a)(1) (2004).

⁶¹ TENN. CODE ANN. § 48-12-105(a)(2) (2004).

⁶² TENN. CODE ANN. § 48-12-105(b) (2004).

does not have to be unanimous.⁶³ In order for an action to be taken without a meeting, the action must receive the number of affirmative votes as would be required to take the same action at a “live” meeting.⁶⁴

D. Bylaws

The bylaws may contain any provision for managing the business and regulating the affairs of the corporation that is not inconsistent with the charter or applicable law.⁶⁵ The Act specifies bylaws as the source of authority and duties of officers.⁶⁶

E. Name

1. Required Words or Abbreviations

Except for insurance or banking businesses, the corporation’s name must contain one of the following words or abbreviations: (i) Corporation, (ii) Incorporated, (iii) Company, (iv) Corp., (v) Inc., (vi) Co. Alternatively, the corporate name may contain “words or abbreviations of like import in another language (provided they are written in roman characters or letters).”⁶⁷

2. Distinctiveness

Except as noted below, the corporate name must be distinguishable from:

(i) The corporate name or assumed name of a corporation incorporated or authorized to transact business in Tennessee;

(ii) A reserved or registered corporate name or assumed corporate name;

(iii) The corporate name of a not-for-profit corporation incorporated or authorized to transact business in Tennessee;

⁶³ *Id.*

⁶⁴ *Id.*

⁶⁵ TENN. CODE ANN. § 48-12-106(b) (2004).

⁶⁶ TENN. CODE ANN. § 48-18-402 (2004).

⁶⁷ TENN. CODE ANN. § 48-14-101(a) (2004).

(iv) A limited partnership name reserved or organized under the laws of Tennessee or registered as a foreign limited partnership in Tennessee; and

(v) The name of a limited liability company authorized to do business as a foreign limited liability company in Tennessee.⁶⁸

3. Assumed Name

A domestic corporation or a foreign corporation authorized to transact business or applying for a certificate of authority to transact business may elect to adopt an assumed corporate name.⁶⁹ Subject to certain limitations,⁷⁰ an assumed name is any name used by the corporation other than its true corporate name. An assumed name must comply with the requirements listed above regarding corporate names, except that an assumed name is not required to contain any certain words or abbreviations.⁷¹

Before transacting any business in Tennessee under an assumed corporate name, the corporation must, pursuant to resolution by its board of directors, execute and file an application setting forth the true corporate name, the state or country under the laws of which it is organized, that it intends to transact business under an assumed corporate name, and the assumed corporate name which it proposes to use.⁷² The right to use an assumed name is effective for five years from the date of filing with the Secretary of the State.⁷³

4. Reserved Name

A person may reserve the exclusive use of a corporate name by delivering an application and a \$20 fee⁷⁴ to the Secretary of State for filing.⁷⁵ If the Secretary of

⁶⁸ TENN. CODE ANN. § 48-14-101(b) (2004).

⁶⁹ TENN. CODE ANN. § 48-14-101(d) (2004).

⁷⁰ *Id.*

⁷¹ *Id.*

⁷² TENN. CODE ANN. § 48-14-101(d)(2) (2004). Application for Registration of Assumed Corporate Name, at <http://www.state.tn.us/sos/forms/ss-4402.pdf>.

⁷³ TENN. CODE ANN. § 48-14-101(d)(3) (2004).

⁷⁴ TENN. CODE ANN. § 48-11-303 (2004).

State finds that the corporate name satisfies the requirements of section 48-54-101 and is available,⁷⁶ the Secretary of State shall reserve the name for the applicant's exclusive use for a four-month period.⁷⁷

5. Registered Name⁷⁸

A foreign corporation may register its corporate or assumed name if the name is distinguishable from other corporate names on file with the Tennessee Secretary of State.⁷⁹ The registration is effective for the balance of the calendar year and is annually renewable.⁸⁰ A \$20 fee must accompany the application.⁸¹

F. Registered Agent and Office

Each corporation must continuously maintain in this state both a registered office and a registered agent.⁸² A registered agent may be an individual who resides in Tennessee, a domestic corporation, or a foreign corporation authorized to transact business in this state.⁸³ A registered office in Tennessee must be a business address

⁷⁵ TENN. CODE ANN. § 48-54-102 (2004). Application for Reservation of Corporate Name, *at* <http://www.state.tn.us/sos/forms/ss-4428.pdf>.

⁷⁶ A document entitled "Business Name Availability Guidelines" is available on the Tennessee Secretary of State's Website, at <http://www.state.tn.us/sos/forms/busname.pdf>. This document provides guidance in determining whether a corporate name is "available." A searchable database called "Business Name Availability" is also helpful in determining whether a proposed name is distinguishable. This database is available on the Tennessee Secretary of State's Website, *at* <http://www.tennesseeanytime.org/sosname/>.

⁷⁷ TENN. CODE ANN. § 48-54-102(a) (2004).

⁷⁸ The Application for Registration of Corporate Name, *at* <http://www.state.tn.us/sos/forms/ss-4429.pdf>.

⁷⁹ TENN. CODE ANN. § 48-14-103(a) (2004).

⁸⁰ TENN. CODE ANN. § 48-14-103(c) (2004).

⁸¹ TENN. CODE ANN. § 48-11-303(a) (2004).

⁸² TENN. CODE ANN. § 48-15-101 (2004).

⁸³ TENN. CODE ANN. § 48-15-104(a)(2) (2004). If a registered agent resigns or is unable to perform his or her duties, the designating corporation shall promptly designate another registered agent so that the corporation will at all times have a registered agent in Tennessee. TENN. CODE ANN. § 48-15-101(b) (2004).

of the registered agent and may be the same as any of the corporation's places of business.⁸⁴ Also note that this information must be included in the original charter.⁸⁵

G. Initial Officers and Directors

No later than the date of the organizational meeting, each corporation must name at least one director to its board of directors and have a President and a Secretary, who must be different individuals.⁸⁶

H. Filing of Charter with Register of Deeds

A copy of the charter and related documents must be filed with the Register of Deeds in the county in Tennessee where, if at all, the corporation maintains its principal place of business in this state.⁸⁷ A filing fee of \$5, plus fifty cents for each page exceeding five pages, may be charged.⁸⁸

III. TENNESSEE TAX ISSUES

A. Franchise Tax and Excise Tax

Franchise and excise taxes are privilege taxes. Generally, all corporations and LLCs in Tennessee are subject to both the franchise tax and the excise tax.⁸⁹ All businesses subject to either of these taxes must register with the Tennessee Department of Revenue by completing and filing the Application for Franchise, Excise Tax Registration form.⁹⁰ This form must be filed within fifteen days of the date on which the business becomes subject to the tax.⁹¹

⁸⁴ TENN. CODE ANN. § 48-15-101(a) (2004).

⁸⁵ TENN. CODE ANN. § 48-12-102(a)(3) (2004).

⁸⁶ TENN. CODE ANN. § 48-12-105(a)(2) (2004). For more information about officers of the corporation, see *infra* Part IV.A. For more information about directors of a corporation, see *infra* Part IV.B.

⁸⁷ TENN. CODE ANN. § 48-11-303(d) (2004).

⁸⁸ TENN. CODE ANN. § 48-11-303(d) (2004).

⁸⁹ TENN. CODE ANN. §§ 67-4-2007(a), 67-4-2105(a) (2004).

⁹⁰ See <http://www.state.tn.us/revenue/forms/fac/facapply99.pdf>.

⁹¹ TENN. CODE ANN. § 67-4-2003(c) (2004).

1. Due Dates

The Franchise, Excise tax return is due the fifteenth day of the fourth month following the close of the business's books and records. The return form⁹² will be sent automatically to the registered agent's address as stated in the Charter. Quarterly estimated payments are due the fifteenth day of the fourth, sixth, and ninth months of the current tax year and the fifteenth day of the first month of the next tax year. A six-month extension will be granted upon request.⁹³

2. Tax Rates

The franchise tax is based on values shown on a company's balance sheet at the end of its fiscal year.⁹⁴ The franchise tax rate is 0.25% of the greater of (1) the net worth or (2) the value of real and tangible property in Tennessee. The net worth is defined as total assets less total liabilities, determined in accordance with generally accepted accounting principles ("GAAP"). Treasury stock is not included in net worth. The minimum tax is \$100.⁹⁵

The excise tax is 6.5% of Tennessee net earnings.⁹⁶ Net earnings are defined as federal taxable income before the operating loss deduction and special deductions subject to certain state adjustments.⁹⁷ Those adjustments are listed at section 67-4-2006(b).

3. Apportionment

Taxpayers doing business both in and out of the state of Tennessee, within the meaning of section 67-4-2010, so as to be entitled to apportionment, shall apportion net earnings or net loss using the appropriate apportionment formula.⁹⁸

⁹² The Franchise, Excise Tax Return form, *at* <http://www.state.tn.us/revenue/forms/fae/newfe1702002.pdf>.

⁹³ The Application for Extension of Time to File Franchise, Excise Return, *at* <http://www.state.tn.us/revenue/forms/fae/fae173.pdf>.

⁹⁴ *Id.*

⁹⁵ *Id.*

⁹⁶ TENN. CODE ANN. § 67-4-2007(a) (2004).

⁹⁷ TENN. CODE ANN. § 67-4-2006(a)(1) (2004).

⁹⁸ TENN. CODE ANN. § 67-4-2006(c) (2004).

When calculating both the franchise and excise tax, corporations that are taxable in states other than Tennessee may apportion the measure of tax between Tennessee and the other states where business activities are taxable. The precise method by which apportionment may be accomplished depends on the tax and the type of business.⁹⁹

4. Excise Tax Apportionment Formula¹⁰⁰

$$\text{Net business earnings}^{101} \cdot \frac{(\text{property factor} + \text{payroll factor} + 2 \cdot (\text{receipts factor}))}{4}$$

Property factor¹⁰²=

$$\frac{\text{Average value of taxpayer's real and tangible personal property owned or rented and used in Tennessee during tax period}}{\text{Average value of taxpayer's real and tangible personal property owned or rented and used during tax period}}$$

Payroll factor¹⁰³=

$$\frac{\text{Total amount paid in Tennessee during the tax period by the taxpayer for compensation to employees}}{\text{Total amount paid everywhere during the tax period by the taxpayer for compensation to employees}}$$

Receipts factor¹⁰⁴=

$$\frac{\text{Total receipts of taxpayer in Tennessee during the tax period}}{\text{Total receipts of the taxpayer everywhere}}$$

Non-business earnings are allocated in accordance with section 67-4-2011.

⁹⁹ See TENN. CODE ANN. §§ 67-4-2013, 67-4-2113 (2004) (stating special apportionment formulas for common carriers, air carriers, air express carriers, and insurance companies).

¹⁰⁰ TENN. CODE ANN. § 67-4-2012(a) (2004).

¹⁰¹ Business earnings are earnings that arise in the regular course of the taxpayer's business. TENN. CODE ANN. § 67-4-2004(1) (2004).

¹⁰² TENN. CODE ANN. § 67-4-2012(b) (2004).

¹⁰³ TENN. CODE ANN. § 67-4-2012(c) (2004).

¹⁰⁴ TENN. CODE ANN. § 67-4-2012(g) (2004).

5. Franchise Tax Apportionment Formula¹⁰⁵

$$\text{Net worth} \cdot \frac{(\text{property factor} + \text{payroll factor} + 2 \cdot (\text{receipts factor}))}{4}$$

Property factor¹⁰⁶=

Average value of taxpayer's real and tangible personal property,
excluding exempt inventory, owned or rented and used in Tennessee
during the tax period

Average value of taxpayer's real and tangible personal property,
excluding exempt inventory, owned or rented and used during tax
period

Payroll factor¹⁰⁷=

Total amount paid in Tennessee during the tax period by the taxpayer
for compensation

Total amount paid everywhere during the tax period by the taxpayer
for compensation

Receipts factor¹⁰⁸=

Total receipts of the taxpayer in Tennessee during the tax period

Total receipts of the taxpayer everywhere during the tax period

B. Sales and Use Tax

If a business is involved in manufacturing, distributing, selling, renting, or leasing tangible personal property, or providing taxable services, the business must

¹⁰⁵ TENN. CODE ANN. § 67-4-2111(a) (2004).

¹⁰⁶ TENN. CODE ANN. § 67-4-2111(b) (2004).

¹⁰⁷ TENN. CODE ANN. § 67-4-2111(e) (2004).

¹⁰⁸ TENN. CODE ANN. § 67-4-2111(g) (2004).

hold a Certificate of Registration¹⁰⁹ to conduct business in Tennessee. A business that has more than one location in Tennessee must hold a Certificate for each location.

The sales tax rate varies by location in the state.¹¹⁰ The state levies a 7% tax on each item or article of tangible personal property sold at retail¹¹¹ in the state and a 6% tax on the retail sale of food and food ingredients subject to certain exceptions.¹¹² In addition, counties and cities may levy a local option tax, provided that the tax is applicable to only the first \$1600 of sale or use of any single item of personal property.¹¹³

The use tax is the counterpart to the sales tax. The use tax rate is the same as the sales tax rate and is imposed on the sale of tangible personal property when the tangible personal property is not sold, but is used, consumed, distributed, or stored for use or consumption in Tennessee provided that there is no duplication of the tax.¹¹⁴

A corporation must file the sales and use tax return¹¹⁵ monthly, quarterly, or annually, based on the corporation's qualifications.¹¹⁶ If the corporation is required

¹⁰⁹ The Application for Registration for the Sales and Use Tax, *at* http://www.state.tn.us/revenue/forms/general/f13005_1.pdf.

¹¹⁰ See Tennessee Department of Revenue Chart, *at* <http://www.state.tn.us/revenue/pubs/taxlist.pdf>

¹¹¹ TENN. CODE ANN. § 67-6-202(a) (2004). There is an additional tax at the rate of 2.75% “on the amount in excess of one thousand six hundred dollars (\$1,600), but less than or equal to three thousand two hundred dollars (\$3,200), on the sale or use of any single article of personal property as defined in § 67-6-702(d).” *Id.*

¹¹² TENN. CODE ANN. § 67-6-228(a) (2004).

¹¹³ TENN. CODE ANN. § 67-6-202(a) (2004). A chart detailing the local option rates for each city and county in Tennessee is available at <http://state.tn.us/revenue/pubs/taxlist.pdf>.

¹¹⁴ TENN. CODE ANN. § 67-6-203(a) (2004).

¹¹⁵ The Revised State and Local Sales and Use Tax Return form, *at* <http://www.state.tn.us/revenue/forms/sales/2002sls450after715.pdf>. Instructions for the preparation of the Tennessee Sales or Use Tax Returns, *at* <http://www.state.tn.us/revenue/forms/sales/saleinst.pdf>.

¹¹⁶ TENN. CODE ANN. § 67-5-505 (2004); TENN. COMP. R. & REGS. Ch. 1320-5-1-.74 (1), (2)(a) (2004).

to file a monthly return, the return is due on the twentieth day of the month following the end of the reporting period.¹¹⁷

C. Annual Reports

With limited exceptions,¹¹⁸ domestic corporations and foreign corporations authorized to transact business in Tennessee must file an annual report each year.¹¹⁹ This report contains information about the corporation such as its name and the state or country where it is incorporated, the address of its registered office, the name of its registered agent, and the names and addresses of its directors and principal officers.¹²⁰ The annual report form¹²¹ is due on the first day of the fourth month following the close of the corporation's fiscal year and the corporation must file with the Secretary of State¹²² accompanied by a \$20 filing fee.¹²³ Failure to file an annual report may result in administrative dissolution of the corporation.¹²⁴

D. Business Tax¹²⁵

Prior to engaging in business, every corporation must contact the office of the county clerk in the county where the business will be domiciled along with the city tax collector, if applicable, to register for payment of appropriate business

¹¹⁷ See <http://www.state.tn.us/revenue/tntaxes/salesanduse.htm>.

¹¹⁸ State and local banks are not required to file annual reports. TENN. CODE ANN. § 48-26-203(d) (2004).

¹¹⁹ TENN. CODE ANN. § 48-26-203 (2004).

¹²⁰ TENN. CODE ANN. § 48-26-203(a) (2004).

¹²¹ Annual report forms are not available as blank forms and must be filed on the preprinted forms provided by the Division of Business Services. The forms are prepared and mailed to each active company on an annual basis. Requests for replacement annual report forms may be made to the Division via e-mail, by telephone, or in writing.

¹²² TENN. CODE ANN. § 48-26-203(c) (2004).

¹²³ TENN. CODE ANN. § 48-11-303(a) (2004).

¹²⁴ TENN. CODE ANN. § 48-24-201 (2004).

¹²⁵ See generally The Tennessee Business Tax Guide Aug. 2003, at <http://www.state.tn.us/revenue/taxguides/bustaxguide2003.pdf>.

taxes.¹²⁶ Corporations should contact the appropriate county or city official to obtain information and forms for that jurisdiction.¹²⁷

E. State Unemployment Insurance

Most employers¹²⁸ who have workers in Tennessee are required to pay the state unemployment tax (SUTA) premiums. These premiums are used solely to pay unemployment benefits to workers who have lost their jobs through no fault of their own.

A new employer must complete a Report to Determine Status – Application for Employer Number.¹²⁹ If a business is liable for unemployment insurance premiums in Tennessee, it will be assigned an eight-digit employer account number.

All employers covered under Tennessee's Employment Security Law are required to submit Quarterly Premium and Wage reports (Forms LB-0456 and LB-0851).¹³⁰ These reports must be submitted with the appropriate payment by the date due, even if no wages were paid during the quarter. The due dates are April 30th, July 31st, October 31st and January 31st.

Each quarter, covered employers must report total gross wages paid to all employees and pay unemployment insurance premiums based on the first \$7000 paid to each employee in a calendar year. Premiums are calculated by using a premium rate assigned by the Department of Labor each year.

The employer premium rate is dependent upon whether the business is a new employer or an experience-rated employer.¹³¹ New employers in Tennessee are

¹²⁶ TENN. CODE ANN. § 67-4-706 (2004).

¹²⁷ The following website is useful for obtaining contact information for county and city officials: <http://www.tennesseeanytime.org/local/index.html>.

¹²⁸ Employers are subject to this tax if (1) total payroll equals or exceeds \$1500 in any calendar quarter in either the current or preceding calendar year, or (2) if the business has at least one employee on any day during twenty different calendar weeks in either the current or the preceding calendar year. TENN. CODE ANN. § 50-7-205 (2004).

¹²⁹ <http://www.state.tn.us/labor-wfd/Employers/forms/LB-0441.pdf>.

¹³⁰ These forms are not currently available online. To obtain these forms, contact the Tennessee Department of Labor at 1.800.344.8337 (if calling from within Tennessee), or call 1.615.741.2486 (if calling from outside Tennessee).

¹³¹ TENN. CODE ANN. § 50-7-403(a) (2004).

initially subject to a "new employer" rate until their account has been subject to premiums and chargeable with benefits for thirty-six consecutive months ending on the computation date (December 31st of each year).¹³² Beginning on the following July 1st, they then become eligible for a premium rate based on their individual reserve experience.¹³³ New employer rates are determined separately for each major industry group.¹³⁴ "New employer" rates for each industry are determined each year effective July 1st.¹³⁵ All industries, except construction, manufacturing, and mining, currently have a new employer rate of 2.7%.¹³⁶

An experience-rated employer is an employer who has paid unemployment insurance premiums for thirty-six consecutive months ending on December 31st.¹³⁷ An experience-rated employer's premium rate is determined by two factors: the employer's reserve ratio¹³⁸ and the level of the unemployment insurance compensation trust fund.¹³⁹ Generally, covered employers must also pay a Job Skills Fee quarterly, based on the first \$7000 paid to each employee in a calendar year.¹⁴⁰

F. Worker's Compensation Insurance

Every employer is required to display the Tennessee Workers' Compensation Insurance notice.¹⁴¹ If an employer has five or more employees,¹⁴² including part-

¹³² TENN. CODE ANN. § 50-7-403(b)(1)(B) (2004).

¹³³ *Id.*

¹³⁴ *Id.*

¹³⁵ *Id.*

¹³⁶ The new employer rates for construction, manufacturing, and mining, *at* <http://www.state.tn.us/labor-wfd/Employers/empfaq.html#6>.

¹³⁷ TENN. CODE ANN. § 50-7-403(f) (2004).

¹³⁸ An employer's reserve ratio is determined by taking the total premiums the employer has paid as of December 31 and subtracting from that all benefits charged against that employer as of December 31. The difference is then divided by the employer's average payroll for the last three years. The resulting figure is the employer's reserve ratio percent. An employer's premium rate is the rate that corresponds with his reserve ratio on the effective Premium Table. TENN. CODE ANN. § 50-7-403(b)(1)(A) (2004).

¹³⁹ *See* TENN. CODE ANN. § 50-7-403 (2004).

¹⁴⁰ TENN. CODE ANN. § 50-7-451(b) (2004).

¹⁴¹ TENN. CODE ANN. § 50-6-407 (2004). The Tennessee Workers' Compensation Insurance notice, *at* http://www.state.tn.us/labor-wfd/forms/WC_Certificate.pdf.

time employees, full-time employees, and family member employees, or if the business is engaged in the construction industry (even if it has less than five employees) it is required to have workers' compensation insurance. A business may obtain workers' compensation coverage even if it is not required to.

Corporate officers may elect to be exempt from an employer's workers' compensation policy.¹⁴³ Sole proprietors and partners who devote full time to the partnership are excluded from a workers' compensation policy, but may elect coverage.¹⁴⁴

Employers subject to workers' compensation laws must maintain coverage with a private insurer or self-insure if they meet minimum requirements of financial ability to pay claims arising under the law.¹⁴⁵ The Tennessee Department of Commerce and Insurance determines whether a business qualifies for self-insurance¹⁴⁶ and will generally require workers' compensation premiums to be \$350,000 or greater before self-insurance is allowed.¹⁴⁷

IV. CAPITAL STRUCTURE AND FINANCING THE CORPORATION

A. Introduction

Every corporation organized under the laws of Tennessee must authorize the existence of at least one class of shares.¹⁴⁸ Although the former Tennessee General Corporation Act required a minimum of \$1000 consideration for the issuance of

¹⁴² TENN. CODE ANN. § 50-6-102(9) (2004) (defining "employee" for workers compensation provisions).

¹⁴³ TENN. CODE ANN. § 50-6-104 (2004). A corporate officer may elect to be excluded from the employer's workers' compensation policy by filing the appropriate form, available at <http://www.state.tn.us/labor-wfd/forms/i-6.pdf>.

¹⁴⁴ TENN. CODE ANN. § 50-6-102(9)(B) (2004). A sole proprietor or partner may elect to be included in the employer's workers' compensation policy by filing the appropriate form, available at <http://www.state.tn.us/labor-wfd/forms/i-4.pdf>.

¹⁴⁵ TENN. CODE ANN. § 50-6-405(a) (2004).

¹⁴⁶ TENN. CODE ANN. § 50-6-405(b) (2004).

¹⁴⁷ More information regarding qualification requirements for self-insurance is available at <http://www.state.tn.us/commerce/insurance/pdf/forms/findapp.pdf>.

¹⁴⁸ TENN. CODE ANN. § 48-16-101 (2004).

initial shares, the TBCA prescribes no minimum value of capitalization.¹⁴⁹ However, a new corporation should have adequate capital in light of its initial anticipated business in order to avoid shareholder liability under a “piercing the corporate veil” theory.¹⁵⁰

B. Classes of Stock

1. Charter Provisions

A corporation’s charter must authorize one or more classes of shares that, in the aggregate, have unlimited voting rights and the right to receive any net assets upon dissolution.¹⁵¹ At all times following initial capitalization, at least one of these types of shares must be outstanding.¹⁵²

The charter must state the number of shares of each class that the corporation is authorized to issue. If the charter authorizes more than one class or series of shares, each class or series must have a unique name.¹⁵³ The preference, limitations, and relative rights of shares of a class must be described in the charter before those shares may be issued.¹⁵⁴ Generally, all shares of a particular class must have preferences, limitations, and relative rights identical to other shares in the same class.¹⁵⁵ However, the description of a series within a class may provide that its preferences, limitations, and relative rights are not identical to other series in its class.¹⁵⁶

¹⁴⁹ TENN. CODE ANN. § 48-16-101(c)(5) (2004). *But see* TENN. CODE ANN. § 56-32-212 (2004) (capitalization requirements for health maintenance organizations); TENN. CODE ANN. § 45-2-207 (2004) (“A state bank shall have such capital structure as the commissioner shall deem adequate.”).

¹⁵⁰ *See infra* Part VIII for more information about piercing the corporate veil.

¹⁵¹ TENN. CODE ANN. § 48-16-101(b) (2004).

¹⁵² TENN. CODE ANN. § 48-16-103(c) (2004).

¹⁵³ TENN. CODE ANN. § 48-16-101(a) (2004) (distinguishing designations required for classes of shares); TENN. CODE ANN. § 48-16-102(b) (2004) (distinguishing designations required for series of shares).

¹⁵⁴ TENN. CODE ANN. § 48-16-101(a) (2004). If the charter does not already describe these characteristics of the class, it must be amended.

¹⁵⁵ *Id.*

¹⁵⁶ TENN. CODE ANN. § 48-16-102(c) (2004).

The charter may include a “blank check” provision empowering the board of directors, rather than shareholders, to specify,¹⁵⁷ in whole or part, the preferences, limitations, and relative rights of any unissued class or series of shares.¹⁵⁸

A charter may authorize one or more classes of shares that:

- Have no voting rights as long as there is one class of voting stock;
- Are redeemable or convertible;¹⁵⁹
- Entitle the holders to distributions calculated in any manner;¹⁶⁰
- Have preferences over any other class of shares with respect to distributions;¹⁶¹ or
- Have a par value.¹⁶²

2. No Property Right in Charter Provisions

The TBCA provides that a shareholder of a corporation does not have a vested property right resulting from any provision in the charter or bylaws.¹⁶³ Each

¹⁵⁷ The board of directors must file articles of amendment to the charter, which are effective without shareholder approval, with certain information such as the name of the corporation and the date the board of directors adopted the amendment. TENN. CODE ANN. § 48-16-102(d) (2004). The Articles of Amendment to the Charter, at <http://www.state.tn.us/sos/forms/ss-4421.pdf>.

¹⁵⁸ TENN. CODE ANN. § 48-16-102(a) (2004). The ability of the board of directors to make this determination is subject to the limitations set forth in section 48-16-101. *Id.*

¹⁵⁹ TENN. CODE ANN. § 48-16-101(c)(2) (2004). The charter must specify whether the redemption or conversion (1) will occur at the option of the corporation, shareholder, or another person or upon the occurrence of a designated event; (2) is for cash, indebtedness, securities or other property; and (3) is in a designated amount or is in an amount determined in accordance with a designated formula or by reference to extrinsic data or events. *Id.*

¹⁶⁰ TENN. CODE ANN. § 48-16-101(c)(3) (2004).

¹⁶¹ TENN. CODE ANN. § 48-16-101(c)(4) (2004).

¹⁶² TENN. CODE ANN. § 48-16-101(c)(5) (2004). Shares may have a stated par value, provided that the mere recitation of a par value for shares shall not create a requirement for a minimum consideration for the issuance of any such shares or impose any other restriction on their issuance or create any other right or liability with respect thereto. *Id.*

¹⁶³ TENN. CODE ANN. § 48-20-101(b) (2004).

shareholder must protect himself against discriminatory future charter amendments by bargaining for charter provisions that limit the right of the board of directors and other shareholders to amend particular charter provisions.¹⁶⁴

C. Sale of Stock by a Corporation Under the TBCA

1. Introduction

An offer by a Tennessee corporation to sell stock to Tennessee residents is governed by the TBCA, the Federal Securities Act of 1933, as amended (the “1933 Act”), and the Tennessee Securities Act of 1980, as amended (the “Tennessee Securities Act”). The corporation that issues shares of stock is identified as an “issuer” in securities law parlance.

2. Subscription for Shares

A subscription¹⁶⁵ to purchase shares is enforceable only if it is in writing.¹⁶⁶ When the subscription agreement is entered into before incorporation, the subscription is irrevocable for six months unless the subscription agreement provides otherwise or all the subscribers agree to revocation.¹⁶⁷ When the subscription agreement is entered into after incorporation, the subscription “is a contract between the subscriber and the corporation subject to section 48-16-202.”¹⁶⁸

3. Stock Certificates

Stock certificates must be signed by two officers of the corporation (typically, the President and the Secretary), either manually or in facsimile.¹⁶⁹ The Act also provides for the use of stock without certificates.¹⁷⁰

¹⁶⁴ TENN. CODE ANN. § 48-20-101(a) (2004).

¹⁶⁵ A subscription is “[a] written contract to purchase newly issued shares of stock or bonds.” BLACK’S LAW DICTIONARY 1441 (7th ed. 1999).

¹⁶⁶ TENN. CODE ANN. § 48-16-201(a) (2004) (regarding pre-incorporation subscriptions); TENN. CODE ANN. § 48-16-201(e) (regarding post-incorporation subscriptions).

¹⁶⁷ TENN. CODE ANN. § 48-16-201(a) (2004).

¹⁶⁸ TENN. CODE ANN. § 48-16-201(e) (2004).

¹⁶⁹ TENN. CODE ANN. § 48-16-206(d)(1) (2004).

¹⁷⁰ TENN. CODE ANN. § 48-16-207(a) (2004).

4. Required Consideration

Shareholders must pay for shares with “adequate” consideration.¹⁷¹ The consideration may consist of cash, promissory notes, tangible or intangible property, past or future services, other benefits to be received, or other securities of the corporation.¹⁷² The board of directors must make the determination of whether the consideration is adequate unless the charter reserves that right to the shareholders.¹⁷³

The corporation may place in escrow shares purchased with promissory notes or the promise of future services or benefits and issue the shares in installments as the shareholder performs his obligations.¹⁷⁴ The corporation may cancel escrowed shares in whole or in part if the shareholder defaults.¹⁷⁵ In general, a transferee of shares issued in exchange for a note or a future services contract is liable only to the extent of the consideration for which the shares were authorized to be issued.¹⁷⁶ Therefore, it is advisable that companies place these shares in escrow.

5. Options and Warrants

Unless limited or prohibited by the charter, the board of directors is empowered to grant rights, warrants, and options to purchase shares of any authorized class or series up to the maximum number of authorized shares that would be available if exercised.¹⁷⁷ If insufficient authorized shares are available for this purpose, the granting of the rights, options, or warrants is subject to approval by the holders of the classes of shares necessary to amend the charter to increase the number of authorized shares.¹⁷⁸

¹⁷¹ TENN. CODE ANN. § 48-16-202(c) (2004).

¹⁷² TENN. CODE ANN. § 48-16-202(b) (2004).

¹⁷³ TENN. CODE ANN. § 48-16-202(a), (c) (2004).

¹⁷⁴ TENN. CODE ANN. § 48-16-202(e) (2004). In most cases, attorneys should advise their clients to place such shares in escrow.

¹⁷⁵ *Id.*

¹⁷⁶ TENN. CODE ANN. § 48-16-203 (2004).

¹⁷⁷ TENN. CODE ANN. § 48-16-205(a) (2004).

¹⁷⁸ TENN. CODE ANN. § 48-16-205(a)(2) (2004).

6. Preemptive Rights

The TBCA abolished shareholders' preemptive rights unless those rights are expressly provided for in the charter.¹⁷⁹ If a corporation includes in its charter the phrase "the corporation elects to have pre-emptive rights" or a statement of similar import, certain principles will apply to that corporation, unless the charter expressly provides otherwise.¹⁸⁰ These principles include special preemptive rights for both voting and non-voting shareholders.¹⁸¹ However, preemptive rights do not apply to certain types of stock.¹⁸²

V. SHAREHOLDER RIGHTS

A. Meetings

1. Annual Meetings

A corporation must hold at least one shareholders' meeting per year.¹⁸³ The date of the meeting or the manner of fixing the date must be set forth in the bylaws.¹⁸⁴ Generally, the bylaws also specify a location or manner of selecting the location for the annual meeting.¹⁸⁵ A corporation's failure to hold an annual meeting at the time determined in the bylaws does not affect the validity of any corporate action.¹⁸⁶

2. Special Meetings

A special meeting may be convened by the board of directors, by persons designated in the charter or bylaws, or unless otherwise provided in the charter,

¹⁷⁹ TENN. CODE ANN. § 48-16-301(a) (2004).

¹⁸⁰ TENN. CODE ANN. § 48-16-301(b) (2004).

¹⁸¹ See TENN. CODE ANN. § 48-16-301(b)(1) (2004).

¹⁸² TENN. CODE ANN. § 48-16-301(b)(3)(A)-(D) (2004).

¹⁸³ TENN. CODE ANN. § 48-17-101(a) (2004).

¹⁸⁴ *Id.* TENN. CODE ANN. § 48-17-101(b) (2004).

¹⁸⁵ *Id.* If the bylaws do not determine the location of the annual meeting, it must be held at the corporation's principal office. *Id.*

¹⁸⁶ TENN. CODE ANN. § 48-17-101(c) (2004).

holders of 10% or more of the shares entitled to vote on a matter proposed for consideration upon delivering written demand to the corporate secretary.¹⁸⁷

Special shareholders' meetings are held at the place stated in or fixed in accordance with the corporation's bylaws. If no place is stated or fixed in accordance with the bylaws, special meetings are held at the corporation's principal office.¹⁸⁸

3. Notice

Generally, a corporation must give notice of annual or special meetings only to the shareholders entitled to vote at the meeting.¹⁸⁹ This notice must occur no fewer than ten days nor more than two months before the date of the meeting.¹⁹⁰ The notice generally need not specify the purpose of an annual meeting.¹⁹¹ However, notice for a special meeting must include the purpose of the meeting.¹⁹²

The corporation must generally give notice in writing, but oral notice is effective if it is reasonable under the circumstances and not prohibited by the charter or bylaws.¹⁹³ Notice may be given by facsimile transmission, by wire or wireless communication, by private carrier, or by mail.¹⁹⁴ Written notice to a corporation's shareholders is effective when mailed so long as it is comprehensible, mailed "postpaid," and addressed to the shareholder's address shown in the corporation's current record of shareholders.¹⁹⁵

¹⁸⁷ TENN. CODE ANN. § 48-17-102(a) (2004).

¹⁸⁸ TENN. CODE ANN. § 48-17-102(c) (2004).

¹⁸⁹ TENN. CODE ANN. § 48-17-105(a) (2004).

¹⁹⁰ *Id.*

¹⁹¹ TENN. CODE ANN. § 48-17-105(b) (2004).

¹⁹² TENN. CODE ANN. § 48-17-105(c) (2004). "Only business within the purpose or purposes described in the meeting notice . . . may be conducted at a special shareholders' meeting." TENN. CODE ANN. § 48-17-102(d).

¹⁹³ TENN. CODE ANN. § 48-11-202(a) (2004).

¹⁹⁴ TENN. CODE ANN. § 48-11-202(b) (2004). This section also specifies other permitted forms of notice. *Id.*

¹⁹⁵ TENN. CODE ANN. § 48-11-202(c) (2004). Presumably, "postpaid" means first class mail. To determine the effective date of notice in other circumstances, see TENN. CODE ANN. § 48-11-202(e), (f) (2004).

A shareholder may waive notice at any time.¹⁹⁶ The waiver must be in writing, signed by the shareholder, and delivered to the corporation so it may be included in the minutes or filed in the corporate records.¹⁹⁷ Unless a shareholder objects at the beginning of the meeting, his attendance at the meeting constitutes a waiver of any objection to lack of notice.¹⁹⁸ In addition, a shareholder waives objection to the consideration of a particular matter that is not within the announced purpose of the meeting unless the shareholder objects when the matter is presented.¹⁹⁹

4. Court-Ordered Meetings

A court of the jurisdiction in which a corporation's principal office is located may order a meeting to be held on application of any shareholder of the corporation entitled to participate in an annual meeting if an annual meeting was not held during the proper time period.²⁰⁰ The court may also order a meeting to be held on application of any shareholder who signed a valid demand for a special meeting if the notice was not given within the proper time period²⁰¹ or the special meeting was not held in accordance with the notice.²⁰²

The court has very broad authority to order a meeting. Among other powers, the court may fix the time and place of the meeting, determine the shares entitled to participate in the meeting, specify a record date, and fix the quorum required for specific matters to be considered at the meeting.²⁰³

¹⁹⁶ TENN. CODE ANN. § 48-17-106(a) (2004).

¹⁹⁷ *Id.*

¹⁹⁸ TENN. CODE ANN. § 48-17-106(b)(1) (2004).

¹⁹⁹ TENN. CODE ANN. § 48-17-106(b)(2) (2004).

²⁰⁰ TENN. CODE ANN. § 48-17-103(a)(1) (2004). The proper time period for an annual meeting to be held is within the earlier of six months after the end of the corporation's fiscal year or fifteen months after its last annual meeting. *Id.*

²⁰¹ TENN. CODE ANN. § 48-17-103(a)(2)(A) (2004). Notice must be given within one month after the date the demand was delivered to the corporation's secretary. *Id.*

²⁰² TENN. CODE ANN. § 48-17-103(a)(2)(B) (2004).

²⁰³ TENN. CODE ANN. § 48-17-103(b) (2004).

B. Action Without a Meeting

Any action that is required or permitted to be taken at a shareholders' meeting may be taken without a meeting if the shareholders entitled to vote on the action give unanimous written consent.²⁰⁴ The consent to take the action without a meeting is separate from the shareholders' vote on the action itself.²⁰⁵ In other words, shareholders who approve a vote on the action without a meeting may nevertheless vote against the action.

The action must be evidenced by one or more written consents that indicate each shareholder's vote or abstention on the action and by the signature of each shareholder entitled to vote.²⁰⁶ The consent must be delivered to the corporation so that it may be included in the corporation's minutes or filed with the corporate records.²⁰⁷

C. Voting

1. Matters Requiring Shareholder Approval

The TBCA requires that certain matters be subject to approval of the shareholders. The charter may allocate the voting rights on these issues among one or more series or classes of shares. In any event, at least one class or series or some combination of one or more classes or series must possess the requisite shareholder voting rights, even if certain of the series or classes are excluded altogether from voting.

In general, the matters that the Act subjects to shareholder approval (and on which a charter cannot disenfranchise shareholders) are:

- Election of the board of directors;²⁰⁸
- Removal of directors;²⁰⁹

²⁰⁴ TENN. CODE ANN. § 48-17-104(a) (2004).

²⁰⁵ *Id.*

²⁰⁶ *Id.*

²⁰⁷ *Id.*

²⁰⁸ TENN. CODE ANN. § 48-17-209(a) (2004).

- Approval of a merger plan;²¹⁰
- Sale or other disposition of all or substantially all of a corporation's assets not in the usual and regular course of business;²¹¹
- Approval of a share exchange;²¹²
- Dissolution.²¹³

The Act mandates that shareholders of a class or series are entitled to vote as a separate voting group²¹⁴ on a proposed charter amendment, even if the class or series is designated as nonvoting, if the amendment would:

- Increase or decrease the number of authorized shares of the class or series;

²⁰⁹ TENN. CODE ANN. § 48-18-108 (2004). This section provides for several limitations on the removal of directors. See TENN. CODE ANN. § 48-18-108(a) (2004) (charter may provide that directors may be removed only for cause); TENN. CODE ANN. § 48-18-108(b) (2004) (director elected by voting group may only be removed without cause by that voting group); TENN. CODE ANN. § 48-18-108(c) (2004) (cumulative voting considerations); TENN. CODE ANN. § 48-18-108(d) (2004) (charter may provide for removal for cause by a majority vote of the entire board of directors); TENN. CODE ANN. § 48-18-108(e) (2004) (notice of meeting must state that one purpose of the meeting is removal of directors).

²¹⁰ TENN. CODE ANN. § 48-21-104(a) (2004). However, under certain circumstances, shareholders are not entitled to vote on a merger plan. See TENN. CODE ANN. § 48-21-104(h) (2004) (shareholders of acquiring corporation do not vote if the charter of that corporation is not amended in the transaction, their share rights are not modified, and the corporation does not increase its outstanding shares by greater than 20%); TENN. CODE ANN. § 48-21-105(c) (2004) (shareholders of a non-surviving party to a merger not entitled to approve merger plan if acquiring corporation owns 90% or more of the shares of non-surviving corporation; and shareholders of surviving party not entitled to approve merger plan if one party to merger owns 90% of the shares of second party to merger).

²¹¹ TENN. CODE ANN. § 48-22-102(a) (2004). Generally, a sale or other disposition of all or substantially all of the assets of one or more subsidiaries of a corporation is covered under this provision (and must be approved by the shareholders of the corporation) if the subsidiary or subsidiaries constitute all, or substantially all, of the properties of the corporation. *Id.*

²¹² TENN. CODE ANN. § 48-21-104(a) (2004). *But see* TENN. CODE ANN. §§ 48-21-104(h), 48-21-105(c) (2004).

²¹³ TENN. CODE ANN. § 48-24-102(c)(2) (2004).

²¹⁴ See *supra* Part V.C-4.

- Cause an exchange or reclassification of the class into shares of another class or series;
- Cause an exchange or reclassification, or create the right of exchange, of shares of another class or series into shares of the class or series;
- Change the designation, rights, preferences or limitations of the shares of the class or series;
- Split or reverse split the shares of a class or series;
- Create a class or series with senior distribution or liquidation rights to the class or series;
- Make a junior class or series superior to the class or series in distribution or liquidation rights;
- Deny or limit preemptive rights of the class.²¹⁵

2. Matters Not Requiring Shareholder Approval

Unless the charter provides otherwise, a corporation's board of directors may adopt amendments to the corporation's charter without shareholder action to:

- Delete the names and addresses of initial directors;
- Delete the name and address of the initial registered agent or registered office if a statement of change is on file with the Secretary of State;
- Designate or change the address of the principal place of business;
- Designate a stock split to increase the number of shares if the corporation has only one class of shares outstanding;
- Change the corporate name by changing "corporation" to "corp.," "company" to "co.," and "incorporated" to "inc.," or vice-versa, or by adding, deleting, or changing a geographical attribution for the name;
- Change the address of the corporation's current registered office and the name of its current registered agent at that office;

²¹⁵ TENN. CODE ANN. § 48-20-104(a) (2004). This list is not exhaustive.

- Delete the initial principal office, if an annual report is on file with the Secretary of State; or
- Make any other change expressly permitted by the Act to be made without shareholder action.²¹⁶

3. Special Voting Approval Requirements

Directors are elected by a plurality of the shareholders unless the charter specifies otherwise.²¹⁷ There is no cumulative voting unless it is expressly provided for in the charter.²¹⁸ The voting requirement for director elections applies to each class or series entitled in the charter to separate class or series voting.²¹⁹

Generally, each voting group entitled to vote separately on the plan must approve of the plan of merger or exchange by a majority of all the votes entitled to be cast on the plan by that voting group.²²⁰ Similarly, the sale or transfer of all or substantially all of the corporation's assets must be approved by a majority of the votes entitled to be cast on the action.²²¹

4. Quorum

A quorum must exist at a meeting in order for any action to be taken.²²² Unless the charter or the Act provides otherwise,²²³ a majority of the votes entitled to

²¹⁶ TENN. CODE ANN. § 48-20-102 (2004).

²¹⁷ TENN. CODE ANN. § 48-17-209(a) (2004).

²¹⁸ TENN. CODE ANN. § 48-17-209(b) (2004). Cumulative voting may be provided in the charter by including the following statement or words of similar import: “[A designated voting group of] shareholders are entitled to cumulate their votes for directors.” TENN. CODE ANN. § 48-17-209(c) (2004).

²¹⁹ TENN. CODE ANN. § 48-17-207(2004).

²²⁰ TENN. CODE ANN. § 48-21-104(f) (2004). However, the Act, the charter, or the board of directors may require a greater vote or a vote by voting groups. TENN. CODE ANN. § 48-22-102(e) (2004).

²²¹ TENN. CODE ANN. § 48-22-102 (2004). The charter or the board of directors may require a greater vote or a vote by voting groups. *Id.*

²²² TENN. CODE ANN. § 48-17-206(a) (2004).

²²³ An amendment to the charter that adds, changes, or deletes a greater quorum or voting requirement is subject to a special quorum requirement, which is the greater of the existing quorum provision or the proposed quorum requirement. TENN. CODE ANN. § 48-17-208(b) (2004).

be cast on a matter constitutes a quorum on that matter.²²⁴ Action on a matter is approved by a quorum if the number of favorable votes exceeds the number of negative votes; therefore, abstentions count toward the quorum requirement but do not affect voting requirements.

If two or more voting groups are entitled to vote on a matter, each voting group must have a quorum.²²⁵ Action may be taken by one voting group on a matter even though no action is taken by another voting group entitled to vote on the matter.²²⁶

5. Proxy Voting

A shareholder may vote his shares in person or by proxy.²²⁷ The Act sets forth several valid ways in which a shareholder may name a proxy, including by writing,²²⁸ telegram, cablegram, facsimile, or other electronic transmission.²²⁹

6. Record Date

The bylaws may fix or provide a manner for fixing the record date to be used for determining the shareholders entitled to notice of a shareholders' meeting, to demand a special meeting, to vote, or to take any other action.²³⁰ If the record date is

²²⁴ TENN. CODE ANN. § 48-17-206(a) (2004).

²²⁵ TENN. CODE ANN. § 48-17-207(b) (2004).

²²⁶ TENN. CODE ANN. § 48-17-207(b) (2004).

²²⁷ TENN. CODE ANN. § 48-17-203(a) (2004). Proxy is "a person who is authorized to vote another's stock shares." BLACK'S LAW DICTIONARY 1241 (7th ed. 1999).

²²⁸ TENN. CODE ANN. § 48-17-203(b)(1) (2004). The writing authorizing a proxy must be signed by the shareholder or an attorney-in-fact in the case of an individual shareholder, by an authorized officer, director, employee, agent or attorney-in-fact in the case of any other shareholder, or affixing the shareholder's signature to the writing. *Id.*

²²⁹ TENN. CODE ANN. § 48-17-203(b)(2) (2004). The telegram, cablegram, facsimile or other electronic transmission shall either set forth or be submitted with information from which it can be determined that it was authorized by the shareholder. *Id.* A reliable reproduction of any of the foregoing is also permitted so long as it is a complete reproduction of the entire original writing or transmission. TENN. CODE ANN. § 48-17-203(b)(3) (2004).

²³⁰ TENN. CODE ANN. § 48-17-107(a) (2004).

not determined by the bylaws, the board of directors may fix a future date as the record date.²³¹

If the board of directors sets the record date, it may not be more than seventy days before the meeting or action requiring a determination of shareholders.²³² If a meeting is adjourned, the board of directors is permitted to fix a new record date.²³³ However, the board of directors must fix a new record date if the meeting is adjourned to a date more than four months after the date fixed for the original meeting.²³⁴

D. Derivative Lawsuits

The Act establishes standing requirements and other procedures.²³⁵

VI. OFFICERS AND DIRECTORS

A. Officers

1. Requirements

Two officers are required at a minimum: the President and the Secretary, who must be different persons.²³⁶ Additional officers are as designated in the bylaws or appointed by the board of directors.²³⁷ All officers must be appointed or elected by the board of directors unless the charter or bylaws provide otherwise.²³⁸ An

²³¹ *Id.*

²³² TENN. CODE ANN. § 48-17-107(b) (2004).

²³³ TENN. CODE ANN. § 48-17-107(c) (2004).

²³⁴ *Id.* When a court orders a meeting adjourned to a date more than four months after the date fixed for the original meeting, the court may provide that the original record date continues in effect or it may fix a new record date. TENN. CODE ANN. § 48-17-107(d) (2004).

²³⁵ TENN. CODE ANN. § 48-17-401 (2004).

²³⁶ TENN. CODE ANN. § 48-18-401(a), (d) (2004). One individual may simultaneously hold more than one office in a corporation, except the offices of president and secretary. TENN. CODE ANN. § 48-18-401(d) (2004). However, if the corporation has only one shareholder, the same person may hold the offices of both president and secretary. *Id.*

²³⁷ TENN. CODE ANN. § 48-18-401(a) (2004).

²³⁸ *Id.*

officer may appoint other officers or assistant officers only if expressly authorized to do so by the board of directors or the bylaws.²³⁹

2. Authority

Authority of an officer is determined in accordance with the bylaws.²⁴⁰ In addition, the Tennessee Supreme Court has stated a tripartite test to determine whether a corporation is liable for the unauthorized act of an agent:²⁴¹

- The corporation manifested consent or knowingly permitted the agent to assume exercise of authority;
- The third party knew of facts and in good faith had reason to believe, and did believe, that the agent was authorized; and
- The third party changed position in reliance and will be injured or suffer loss if the act done does not bind the corporation.

3. Resignation and Removal of Officers

An officer may resign at any time by delivering notice to the corporation.²⁴² Unless a later date is specified, the resignation is effective when delivered.²⁴³ If the resignation is made effective at a later date, the board of directors may fill the vacated position before the effective date so long as the new officer does not take office until the effective date.²⁴⁴

The board of directors has the power to remove any officer with or without cause.²⁴⁵ Additionally, an officer may remove, with or without cause, any officer he appointed.²⁴⁶ It is important to note that officers under employment contracts may

²³⁹ TENN. CODE ANN. § 48-18-401(b) (2004).

²⁴⁰ TENN. CODE ANN. § 48-18-402 (2004).

²⁴¹ *Knox-Tenn Rental Co. v. Jenkins Ins.*, 755 S.W.2d 33, 40-41 (Tenn. 1988).

²⁴² TENN. CODE ANN. § 48-18-404(a) (2004).

²⁴³ *Id.*

²⁴⁴ *Id.*

²⁴⁵ TENN. CODE ANN. § 48-18-404(b) (2004).

²⁴⁶ *Id.*

be removed, but the corporation may be subject to damages if such removal is a breach of contract.²⁴⁷ In addition, there are federal and state anti-discrimination laws that may limit removal powers under the Act.

4. Standard of Care

Officers of a corporation owe the corporation a duty of care and a duty of loyalty. Although the Act does not use the terms “duty of care” and “duty of loyalty,” it sets forth a three-part test requiring officers:

- To act in good faith;
- With care of an ordinarily prudent person in a similar position; and
- In a manner he believes to be in the best interests of the corporation.²⁴⁸

In addition, in *Knox-Tenn Rental v. Jenkins Insurance*, the Tennessee Supreme Court held an officer of a closely-held corporation to the “quasi-fiduciary” standard of the duty of loyalty and duty of care.²⁴⁹

An officer may rely on other officers or employees, legal counsel, public accountants and other professionals who he reasonably believes are competent as to particular matters in satisfying the duty of care and duty of loyalty.²⁵⁰ Officers who breach the duty of care or duty of loyalty are liable to the corporation for resulting damages.²⁵¹

²⁴⁷ TENN. CODE ANN. § 48-18-405 (2004).

²⁴⁸ TENN. CODE ANN. § 48-18-403(a) (2004).

²⁴⁹ *Knox-Tenn Rental*, 755 S.W.2d at 36-37.

²⁵⁰ TENN. CODE ANN. § 48-18-403(b) (2004). If the officer has knowledge of the matter in question that makes such reliance unwarranted, the officer is not acting in good faith. TENN. CODE ANN. § 48-18-403(c) (2004).

²⁵¹ TENN. CODE ANN. § 48-18-403(d) (2004).

B. Directors

1. Requirements

A board of directors exercises corporate powers and manages the affairs of the corporation.²⁵² The charter or bylaws may prescribe qualifications for directors.²⁵³ In general, all corporations are required to have a board of directors.²⁵⁴ The number of directors is fixed in accordance with the charter or bylaws, and there is no statutory maximum or minimum.²⁵⁵ The charter or bylaws may provide that the board of directors may fix or change the number of directors.²⁵⁶ Alternatively, the charter or bylaws may provide a variable range for the size of the board by fixing a minimum and a maximum number of directors.²⁵⁷ In this case, the shareholders or the board of directors may fix or change the number of directors, within the range.²⁵⁸

2. Election of Directors

Shareholders elect directors at the first annual shareholders' meeting and at each annual meeting thereafter, unless their terms are staggered,²⁵⁹ or unless their terms are for more than one year.²⁶⁰ The charter may authorize certain classes or

²⁵² TENN. CODE ANN. § 48-18-101(b) (2004).

²⁵³ TENN. CODE ANN. § 48-18-102 (2004). Directors do not have to be residents of Tennessee or shareholders of the corporation unless the charter or bylaws so prescribe. *Id.*

²⁵⁴ TENN. CODE ANN. § 48-18-101(a) (2004). However, a corporation that has fifty or fewer shareholders is not required to have a board of directors. TENN. CODE ANN. § 48-18-101(c) (2004). Note that this option is rarely exercised, as it is highly impractical.

²⁵⁵ TENN. CODE ANN. § 48-18-103(a) (2004).

²⁵⁶ TENN. CODE ANN. § 48-18-103(b) (2004). In the absence of such authority in the charter or bylaws, only the shareholders have such authority. *Id.*

²⁵⁷ TENN. CODE ANN. § 48-18-103(c) (2004).

²⁵⁸ *Id.* Note that only the shareholders may change the range for the size of the board or change from a fixed to a variable-range size board or vice versa, unless the charter or bylaws provide otherwise. *Id.*

²⁵⁹ For more information about staggered terms, see TENN. CODE ANN. § 48-18-106 (2004). *See also infra* Part IV.B-3.

²⁶⁰ TENN. CODE ANN. § 48-18-103(d) (2004). For more information about terms that are longer than one year, see TENN. CODE ANN. § 48-18-105(b) (2004). *See also infra* Part IV.B-3.

series of shares to elect a certain number of directors, and each such class or series constitutes a separate voting group.²⁶¹

Directors are elected by a plurality of votes cast by the shares entitled to vote, unless otherwise provided in the charter.²⁶² Cumulative voting is not allowed unless the charter so provides.²⁶³

A vacancy may occur from an increase in the number of directors, a removal with or without cause, or a resignation.²⁶⁴ Unless the charter provides otherwise, if a vacancy occurs on the board of directors, the shareholders or the board of directors may fill the vacancy.²⁶⁵ If a director resigns and makes his resignation effective at a later date, the pending vacancy may be filled, but the new director may not take office until the vacancy occurs.²⁶⁶

3. Term of Directors

Initial directors' terms expire at the first annual shareholders' meeting at which directors are elected.²⁶⁷ For all other directors, their terms expire at the next annual shareholders' meeting following their election unless their terms are staggered, or unless the charter provides for longer terms.²⁶⁸ A director continues to serve until a successor is elected and qualified or until there is a decrease in the number of directors, even if that director's term has expired.²⁶⁹

²⁶¹ TENN. CODE ANN. § 48-18-104 (2004).

²⁶² TENN. CODE ANN. § 48-17-209(a) (2004).

²⁶³ See *supra* note 218.

²⁶⁴ TENN. CODE ANN. § 48-18-110(a), (c) (2004).

²⁶⁵ TENN. CODE ANN. § 48-18-110 (2004). If the shareholders fill the vacancy and a director that was elected by a voting group of shareholders held the vacant office, only that group is entitled to vote to fill the vacancy. TENN. CODE ANN. § 48-18-110(b) (2004).

²⁶⁶ TENN. CODE ANN. § 48-18-110(c) (2004).

²⁶⁷ TENN. CODE ANN. § 48-18-105(a) (2004).

²⁶⁸ TENN. CODE ANN. § 48-18-105(b) (2004). The charter may not provide for terms longer than three years. *Id.* The term of a director elected to fill a vacancy expires at the next shareholders' meeting at which directors are elected. TENN. CODE ANN. § 48-18-105(d) (2004).

²⁶⁹ TENN. CODE ANN. § 48-18-105(e) (2004).

The charter may provide for staggered terms by dividing the total number of directors into two or three groups.²⁷⁰ The terms of the first group expire at the first annual shareholders' meeting after their election; the terms of the second group expire at the second annual meeting after their election; and the terms of the third group, if any, expire at the third annual meeting after their election.²⁷¹ At each annual shareholders' meeting, new directors are chosen for a term of two years (if there are two groups) or three years (if there are three groups) to succeed those whose terms expire.²⁷²

4. Resignation & Removal of Directors

A director may resign at any time by delivering written notice to the board of directors, its chair, or the corporation.²⁷³ The resignation may specify a later date as the effective date of the resignation.²⁷⁴ If a later date is not specified, the resignation is effective immediately.²⁷⁵

Shareholders may remove directors with²⁷⁶ or without cause²⁷⁷ unless the charter provides that they may be removed only for cause.²⁷⁸ Notice of the meeting must state that one purpose of the meeting is removal of directors.²⁷⁹

²⁷⁰ TENN. CODE ANN. § 48-18-106 (2004).

²⁷¹ *Id.*

²⁷² *Id.*

²⁷³ TENN. CODE ANN. § 48-18-107(a) (2004).

²⁷⁴ TENN. CODE ANN. § 48-18-107(b) (2004). If a later date is specified, the vacancy may be filled but the new director will not take office until the vacancy occurs. TENN. CODE ANN. § 48-18-110(c) (2004).

²⁷⁵ TENN. CODE ANN. § 48-18-107(b) (2004).

²⁷⁶ If provided by the charter, any or all of the directors may be removed for cause by a vote of a majority of the entire board of directors. TENN. CODE ANN. § 48-18-108(d) (2004).

²⁷⁷ If a director is elected by a voting group of shareholders, only shareholders of that voting group may vote to remove the director without cause. TENN. CODE ANN. § 48-18-108(b) (2004).

²⁷⁸ TENN. CODE ANN. § 48-18-108(a) (2004).

²⁷⁹ TENN. CODE ANN. § 48-18-108(e) (2004).

If cumulative voting is authorized, a director may not be removed if the number of votes sufficient to elect the director under cumulative voting is voted against the director's removal.²⁸⁰ If cumulative voting is not authorized, a director may be removed only if a majority of the votes cast is in favor of removal.²⁸¹

5. Meetings of Directors

The bylaws should specify the dates or the procedure for scheduling regular meetings. The Act does not specify who should convene regular meetings. Regular meetings may be held without notice of time, date, or purpose, unless the charter or bylaws provide otherwise.²⁸²

Special meetings may be called, unless the bylaws otherwise provide, by any of the following: the chairman of the board, the president of the corporation, or any two directors.²⁸³ Unless the charter or bylaws specify shorter or longer periods, a minimum of two days' notice is required for special meetings.²⁸⁴ No statement of purpose is necessary unless the charter or bylaws require one.²⁸⁵

Regular meetings and special meetings may be conducted by any means of communication that allows all directors participating in the meeting to simultaneously hear each other during the meeting.²⁸⁶ A director participating in a meeting of this type is deemed to be present in person for the meeting.²⁸⁷

6. Action Without Meeting

Unless the charter or bylaws provide otherwise, any action that is required or permitted to be taken at a board of directors' meeting may be taken without a

²⁸⁰ TENN. CODE ANN. § 48-18-108(c) (2004).

²⁸¹ *Id.*

²⁸² TENN. CODE ANN. § 48-18-203(a) (2004).

²⁸³ TENN. CODE ANN. § 48-18-201(a) (2004).

²⁸⁴ TENN. CODE ANN. § 48-18-203(b) (2004). The notice must include the date, time, and place of the meeting. *Id.*

²⁸⁵ *Id.* *But see* TENN. CODE ANN. § 48-18-108(e) (2004) (requiring statement of purpose for removal of officers).

²⁸⁶ TENN. CODE ANN. § 48-18-201(b) (2004).

²⁸⁷ *Id.*

meeting with unanimous written consent from the directors.²⁸⁸ The consent to take the action without a meeting is separate from the directors' vote on the action itself.²⁸⁹ In other words, directors who approve of taking the action without a meeting may nevertheless vote against the action.

The action must be evidenced by one or more written consents²⁹⁰ that indicate each director's vote or abstention on the action and the signature of each director entitled to vote.²⁹¹ The consent must be delivered to the corporation so that it may be included in the corporation's minutes or filed with the corporate records.²⁹²

7. Voting Requirement

The charter or bylaws may determine what constitutes a quorum of directors needed for a vote.²⁹³ However, if the charter or bylaws do not contain such a provision, the number of directors that constitutes a quorum depends on whether the size of the board of directors is fixed or variable-range.²⁹⁴ If there is a fixed board size, a quorum of a board of directors consists of a majority of the fixed number of directors.²⁹⁵ If there is a variable-range size board, a quorum consists of a majority of the number of directors prescribed.²⁹⁶ If no number is prescribed, then a quorum consists of a majority of the number of directors in office immediately before the meeting begins.²⁹⁷

²⁸⁸ TENN. CODE ANN. § 48-18-202(a) (2004).

²⁸⁹ *Id.*

²⁹⁰ The consent may be in the form of minutes to a meeting. *Herskowitz v. Pilot House Motor Inns*, 806 S.W. 2d 531, 533 (Tenn. Ct. App. 1980).

²⁹¹ TENN. CODE ANN. § 48-18-202(a) (2004).

²⁹² *Id.*

²⁹³ TENN. CODE ANN. § 48-18-205(a) (2004). *See* TENN. CODE ANN. § 48-18-205(c) (2004) (minimum number required for quorum).

²⁹⁴ TENN. CODE ANN. § 48-18-205(a) (2004).

²⁹⁵ TENN. CODE ANN. § 48-18-205(a)(1) (2004).

²⁹⁶ TENN. CODE ANN. § 48-18-205(a)(2) (2004).

²⁹⁷ *Id.*

When a quorum is present and unless the charter or bylaws require a greater number of votes, the affirmative vote of a majority of directors present is the act of the board of directors.²⁹⁸ A director present at a meeting who fails to vote is deemed to have assented unless he objects, enters his dissent in the minutes, delivers written notice of his dissent to the presiding officer before the meeting's adjournment, or delivers written notice of his dissent to the corporation immediately after the meeting's adjournment.²⁹⁹

8. Committees of the Board

Unless the charter or bylaws provide otherwise, the board of directors may create one or more committees.³⁰⁰ Each committee must have at least one member.³⁰¹ The creation of a committee and appointments to that committee must be approved by the greater of a majority of all the directors in office when the vote is taken, or the number of directors required by the charter or bylaws to take action under section 48-18-205.³⁰²

A committee may exercise the authority of the board of directors,³⁰³ except that a committee may not do any of following actions:

- (i) Authorize distributions, except according to a board-approved formula;
- (ii) Fill vacancies on the board of directors or its committees;
- (iii) Adopt, amend, or repeal bylaws;
- (iv) Authorize repurchase of the corporation's stock, except according to a board-approved formula; or

²⁹⁸ TENN. CODE ANN. § 48-18-205(c) (2004).

²⁹⁹ TENN. CODE ANN. § 48-18-205(d) (2004).

³⁰⁰ TENN. CODE ANN. § 48-18-206(a) (2004).

³⁰¹ *Id.*

³⁰² TENN. CODE ANN. § 48-18-206(b) (2004). Sections 48-18-201 through 48-18-205 apply to committees and committee members. TENN. CODE ANN. § 48-18-206(c) (2004).

³⁰³ TENN. CODE ANN. § 48-18-206(d) (2004). The committee's authority must be granted by the board of directors or in the charter or bylaws. *Id.*

- (v) Authorize or approve the issuance or sale of the corporation's stock unless specifically authorized by the board of directors,³⁰⁴ or
- (vi) Determine the designation and relative rights, preferences, and limitations of a class or series of shares, unless specifically authorized by the board of directors.³⁰⁵

9. Fiduciary Duty

Directors owe a fiduciary duty, comprised of the duty of care³⁰⁶ and the duty of loyalty, to the corporation and its shareholders. The Act describes the fiduciary duty in a three-pronged test:

- To act in good faith;
- With the care of an ordinarily prudent person in a similar position; and
- In the manner he believes to be in the best interests of the corporation.³⁰⁷

If a disinterested director satisfies the three-pronged test of the Act,³⁰⁸ he will not be liable for any action taken as a director, or any failure to take action.³⁰⁹

³⁰⁴ TENN. CODE ANN. § 48-18-206(e) (2004).

³⁰⁵ *Id.*

³⁰⁶ The principal case describing the duty of care under Delaware law is *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985). The Delaware Supreme Court stated:

Directors must exercise the care that a reasonably prudent person would exercise under similar circumstances. This standard of care requires that prior to making any business decision, the directors inform themselves of all material information reasonably available to them.

³⁰⁷ TENN. CODE ANN. § 48-18-301(a) (2004).

³⁰⁸ Whether a director or officer has properly discharged the duties of office is a question of fact to be determined in each case in view of all the circumstances. *Fitch v. Midland Bank & Trust Co.*, 737 S.W.2d 785 (Tenn. Ct. App. 1987).

³⁰⁹ TENN. CODE ANN. § 48-18-301(d) (2004).

The Tennessee Supreme Court has indicated that the statutory obligations of the Act render a director and an officer, or at least a senior officer, a “quasi-fiduciary” to the corporation and its shareholders subject to the duty of “utmost good faith, loyalty and honesty.”³¹⁰

In a broad sense, the directors and officers of a corporation are its agents. While they may not be in a strict sense trustees, it is well established that they occupy a fiduciary, or more exactly a quasi-fiduciary, relation to the corporation and its stockholders. 18B Am.Jur.2d, Corporations, § 1689, p. 541. An agent is a fiduciary with respect to the matters within the scope of his agency. The very relationship implies that the principal has reposed some trust or confidence in the agent and the agent or employee is bound to the exercise of the utmost good faith, loyalty, and honesty toward his principal or employer. 3 Am.Jur.2d Agency, § 210, p. 713. The correct rule on the status of a corporate officer as a fiduciary is found in Hayes v. Schweikart’s Upholstering Co., 402 S.W.2d 472, 483, 55 Tenn. App. 442 (1965), citing from 19 C.J.S. p. 107, as follows:

“A corporate officer must at all times be loyal to his trust and act in good faith and unselfishly toward the corporation and its stockholders, and cannot assume positions in conflict with the interests of the corporation; but the restrictions on their activities growing out of the fiduciary status extend only to such corporate interests as exist at the time or may reasonably be expected in the development of the corporate business. If the officers transcend or abuse their powers, they are as much responsible to their principal as the agent of an individual, is to him.”

“A mere employee does not ordinarily occupy a position of trust or confidence toward the corporation unless he is also its agent. On the other hand, one employed as manager of a corporation under the control and direction of the president and board of directors has been held to be an employee in a quasi fiduciary capacity, and as such, bound to

³¹⁰ Knox-Tenn Rental v. Jenkins, 755 S.W.2d 33, 36 (Tenn. 1988).

protect the interests of his employer.” Vol. 19 C.J.S. Corporations § 761b, page 107.

We do not believe appellant seriously argues that the foregoing provisions of the Tennessee General Corporation Act, particularly T.C.A. § 48-1-813 delineating the duty of directors and officers, authorizes or condones the fraudulent conduct engaged in by Mr. Carte who was undoubtedly a fiduciary. There is nothing in the General Corporation Act as it existed at the time these acts occurred, or in its revised provisions, (T.C.A. § 48-18-403(3)) to suggest that Carte was acting in good faith or in a manner he reasonably believed to be in the best interest of the corporation.³¹¹

In discharging his fiduciary duty, a director may rely on others, including the following:

- (i) Officers or employees of the corporation whom a director believes to be reliable and competent;³¹²
- (ii) Legal counsel, public accountants and others on matters reasonably believed to be within such others’ competence;³¹³ and
- (iii) Committees of the Board.³¹⁴

However, if a director has reason to believe that reliance upon any of the above individuals is unwarranted, then that director may not, in good faith, rely on them.³¹⁵

³¹¹ *Id.*

³¹² TENN. CODE ANN. § 48-18-301(b)(1) (2004).

³¹³ TENN. CODE ANN. § 48-18-301(b)(2) (2004).

³¹⁴ TENN. CODE ANN. § 48-18-301(b)(3) (2004). *But see* TENN. CODE ANN. § 48-18-206(f) (2004).

³¹⁵ TENN. CODE ANN. § 48-18-301(c) (2004).

VII. DISSOLUTION

A. Voluntary Dissolution

1. Prior to Issuance of Shares or Commencement of Business

If a corporation has either not issued shares or not commenced business, a majority of the incorporators or initial directors may dissolve the corporation by filing articles of dissolution and termination with the Secretary of State.³¹⁶ The articles of dissolution and termination should state the following: the name of the corporation and the date of its incorporation, either that no shares have been issued or the corporation has not commenced business, that the corporation has no outstanding debt, that the net assets of the corporation remaining after winding up have been distributed to the shareholders, if shares were issued, that a majority of the incorporators or initial directors authorized the dissolution, and the date of the dissolution.³¹⁷

2. Proposal by Directors for Shareholders' Consent

A corporation may be dissolved by unanimous written consent of its shareholders.³¹⁸ A corporation's board of directors may also submit a proposal for dissolution³¹⁹ to the shareholders.³²⁰ Generally, for the board of directors' proposal to be adopted, the board of directors must recommend dissolution to the shareholders, and a majority of the shareholders entitled to vote must approve the

³¹⁶ TENN. CODE ANN. § 48-24-101(a) (2004). Articles of Dissolution and Termination by Incorporators or Initial Directors of a For-Profit Corporation, *at* <http://www.state.tn.us/sos/forms/ss-4423.pdf>.

³¹⁷ TENN. CODE ANN. § 48-24-101(a) (2004). Even though section 48-24-101(b) states that the articles of dissolution must be accompanied by a tax clearance verification from the commissioner of revenue, the Filing Guide for For-Profit Corporations, *at* <http://www.state.tn.us/sos/forms/fg-fp.pdf>, states that tax clearance forms are no longer required as of July 1, 1999. Upon proper filing of the aforementioned documents, the corporation will cease to exist. However, the termination of corporate existence does not extinguish any remedy to or against the corporation, its directors, officers or shareholders, for any right or claim existing or any liability incurred, prior to the termination. TENN. CODE ANN. § 48-24-101(b) (2004).

³¹⁸ TENN. CODE ANN. § 48-24-102(a) (2004). Written Consent to Dissolution form, *at* <http://www.state.tn.us/sos/forms/ss-4255.pdf>.

³¹⁹ The board of directors may condition its submission of the proposal for dissolution on any basis. TENN. CODE ANN. § 48-24-102(d) (2004).

³²⁰ TENN. CODE ANN. § 48-24-102(b) (2004).

proposal.³²¹ Proper notice must be given to both voting and non-voting shareholders, and the notice must state that the purpose of the meeting is to consider dissolving the corporation.³²²

Once the dissolution is authorized, the corporation must deliver articles of dissolution to the Secretary of State for filing.³²³ The corporation is dissolved when the articles of dissolution are filed unless a delayed effective date is included in the articles of dissolution.³²⁴ Upon dissolution, the corporation must wind up and liquidate its business and may not otherwise carry on business.³²⁵ The Act specifies several actions that are appropriate during this time period, including collecting assets, discharging liabilities, and distributing property to shareholders.³²⁶

Once a corporation distributes all of its assets to creditors and shareholders and voluntary dissolution proceedings have not been revoked, the corporation must deliver to the Secretary of State articles of termination of corporate existence.³²⁷

3. Disposing of Claims

A corporation may dispose of the known claims against it by following the procedure set forth in section 48-24-106. Generally, the dissolved corporation must provide to claimants written notice that describes the information that must be

³²¹ TENN. CODE ANN. § 48-24-102(c) (2004). *But see* TENN. CODE ANN. § 48-24-102(c)(1) (2004) (when board determines that conflict of interest or other special circumstances exist, the board must make no recommendation regarding dissolution and must communicate the basis for its determination to shareholders); TENN. CODE ANN. § 48-24-102(f) (2004) (under certain circumstances, majority approval of shareholders not required).

³²² TENN. CODE ANN. 48-24-102(c) (2004).

³²³ TENN. CODE ANN. § 48-24-103 (2004). Articles of Dissolution form, at <http://www.state.tn.us/sos/forms/ss-4410.pdf>.

³²⁴ TENN. CODE ANN. § 48-24-103(b) (2004).

³²⁵ TENN. CODE ANN. § 48-24-105(a) (2004).

³²⁶ *Id.*

³²⁷ TENN. CODE ANN. § 48-24-108 (2004). Even though section 48-24-108(b) states that the articles of termination of corporate existence must be accompanied by a tax clearance verification from the commissioner of revenue, the Filing Guide for For-Profit Corporations, at <http://www.state.tn.us/sos/forms/fg-fp.pdf>, states that tax clearance forms are no longer required as of July 1, 1999.

included in the claim and whether the claim is admitted.³²⁸ The written notice must also contain a mailing address to which the claim may be sent, a deadline for making the claim, and a statement that any claims not received by the deadline will be barred.³²⁹

In addition, a corporation may dispose of unknown claims against it by publishing a notice of dissolution in accordance with section 48-24-107. Unknown claims against the corporation are barred unless the claimant commences a proceeding within two years of the publication of the newspaper notice.³³⁰ Claims allowed under section 48-24-107 may be enforced against the dissolved corporation or by recapturing distributions to shareholders.³³¹

B. Involuntary Dissolution

1. Administrative Dissolution

The Secretary of State may commence a proceeding to administratively dissolve a corporation for any reason listed in section 48-24-201, including the corporation's failure to deliver its annual report within two months of its due date or its failure to have a registered agent or registered office in Tennessee for two or more months.³³² The Secretary of State must first provide notice to the corporation that there are grounds for administrative dissolution.³³³ If the corporation does not correct each ground for dissolution within two months, the Secretary of State will dissolve the corporation and provide notice of such dissolution to the company.³³⁴

³²⁸ TENN. CODE ANN. § 48-24-106(b) (2004).

³²⁹ *Id.* Articles of Termination of Corporation Existence form, at <http://www.state.tn.us/sos/forms/ss-4412.pdf>.

³³⁰ TENN. CODE ANN. § 48-24-107(c) (2004).

³³¹ TENN. CODE ANN. § 48-24-107(d) (2004).

³³² TENN. CODE ANN. § 48-24-201 (2004) .

³³³ TENN. CODE ANN. § 48-24-202(a) (2004).

³³⁴ TENN. CODE ANN. § 48-24-202(b) (2004). The administratively dissolved corporation may apply to the secretary of the state for reinstatement. TENN. CODE ANN. § 48-24-203 (2004).

2. Judicial Dissolution

A court of record with proper venue³³⁵ may dissolve a corporation in certain proceedings instituted by the attorney general and reporter, a shareholder, or a creditor.³³⁶ In addition, a corporation may be judicially dissolved in a proceeding instituted by the corporation to have its voluntary dissolution continued under court supervision.³³⁷

VIII. PIERCING THE CORPORATE VEIL

A. Liability of Directors, Officers, and Shareholders

Courts apply multiple factors to determine whether corporate existence will be disregarded in order to hold directors, officers and shareholders personally liable. The United District Court for the Eastern District of Tennessee described the doctrine as follows:

[T]he doctrine that a corporation is a legal entity existing separate and apart from the persons composing it is a legal theory introduced for the purposes of convenience. The concept cannot, therefore, be extended to a point beyond its reason and policy, and when invoked in support of an end subversive of this policy, will be disregarded by the courts. Thus, in an appropriate case and in furtherance of the ends of justice, a corporation and the individual or individuals owning all its stock and assets will be treated as identical, the corporate cloak being disregarded where used as a cover for fraud or illegality and the corporation and individual or individuals owning all its stock and assets will be treated as identical.

Factors to be considered in determining whether to disregard the corporate veil include not only whether the entity has been used to work a fraud or injustice in contravention of public policy, but also: (1) whether there was a failure to collect paid in capital; (2) whether the corporation was grossly undercapitalized; (3) the nonissuance of

³³⁵ Proper venue is determined under section 48-24-302(a). Venue for a proceeding by the attorney general and reporter to dissolve a corporation lies in Davidson County. *Id.* For all other judicial dissolution proceedings, venue lies in the county where the corporation's principal office is or was located. *Id.*

³³⁶ TENN. CODE ANN. § 48-24-301(2004).

³³⁷ TENN. CODE ANN. § 48-24-301(4) (2004).

stock certificates; (4) the sole ownership of stock by one individual; (5) the use of the same office or business location; (6) the employment of the same employees or attorneys; (7) the use of the corporation as an instrumentality or business conduit for an individual or another corporation; (8) the diversion of corporate assets by or to a stockholder or other entity to the detriment of creditors, or the manipulation of assets and liabilities in another; (9) the use of the corporation as a subterfuge in illegal transactions; (10) the formation and use of the corporation to transfer to it the existing liability of another person or entity; and (11) the failure to maintain arms length relationships among related entities.

In addition, when a corporation is dominated by an individual or individuals not only as to finance but also as to policy and business practices so that the corporation has no mind, will, or existence of its own and this domination is used to commit a wrong, or fraud or perpetrate a violation of statutory or positive legal duty, the corporate veil will be pierced.³³⁸

The Tennessee Court of Appeals has adopted a more protective rule of the corporate shield:

[T]o disregard the corporate entity and find personal liability, there must be a demonstration of the use of control to commit fraud or wrong, to perpetrate the violation of a statutory or other positive legal duty, or a dishonest and unjust act in contravention of third parties' rights.³³⁹

B. Liability of Parent for Subsidiary Liabilities

A parent corporation can be held liable for the subsidiary's liabilities if a court "pierces the corporate veil." Ordinarily, an individual corporation and its shareholders are recognized as separate and distinct entities. However, if the

³³⁸ FDIC v. Allen, 584 F. Supp. 386, 397-98 (E.D. Tenn. 1984) (citations omitted).

³³⁹ Newman v. Bartee, 787 S.W.2d 929, 931-32 (Tenn. Ct. App. 1990) (quoting Tennessee Racquetball Investors, Ltd. v. Bell, 709 S.W.2d 617).

subsidiary is a mere alter-ego of the parent corporation or if the subsidiary is created to perpetuate a fraud, courts will disregard the corporate entity.³⁴⁰

Essentially, piercing the corporate veil prevents a parent corporation from avoiding liability by creating and acting through a subsidiary that is undercapitalized and controlled by the parent. In *United States v. Mottolo*,³⁴¹ the court pierced the corporate veil to reach the corporation's owner who admittedly incorporated to avoid personal liability. The court explained that a corporate entity "may not be employed to avoid overriding federal legislative policies, and federal courts will disregard it if the interests of public convenience, fairness, and equity so demand."³⁴² When disregarding the corporate entity, the dispositive factors are parental control of the subsidiary's activities and any significant financial or ownership interests held by the parent.³⁴³

³⁴⁰ See *Bodenhamer Bldg. Corp. v. Architectural Research Corp.*, 873 F.2d 109 (6th Cir. 1989); *T.V.A. v. Exxon Nuclear Co.*, 753 F.2d 493 (6th Cir. 1985); *Laborers' Pension Trust Fund v. Weinberger Homes*, 872 F.2d 702 (6th Cir. 1988).

³⁴¹ *United States v. Mottolo*, 695 F. Supp. 615 (D. N.H. 1988).

³⁴² *Id.* at 624. *Cf. In re Acushnet River & New Bedford Harbor Proceedings*, 675 F. Supp. 22 (D. Mass. 1987) (The court did not pierce the corporate veil because there was a "well-capitalized, non-fraudulent, separate corporate subsidiary" and because the parent did not control the subsidiary to such a level that required piercing the corporate veil.)

³⁴³ See *Bunker Hill*; *United States v. Jon-T Chemicals*, 768 F.2d 686 (5th Cir. 1986) *cert. denied*, 475 U.S. 1014; *United States v. Nicolet, Inc.*, 712 F. Supp. 1193 (E.D. Pa. 1989).