RATIFICATION OF DEFECTIVE CORPORATE ACTS

DELAWARE GENERAL CORPORATION LAW, MODEL BUSINESS CORPORATION ACT AND BEYOND

Melissa A. DiVincenzo, John H. Lawrence Jr., Wendy R. Mullins and Stephanie M. Norman

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Ratification of Defective Corporate Acts -- Delaware, the Model Business Corporation Act and Beyond

The program will describe the background of Sections 204 and 205 of the Delaware General Corporation Law (DGCL), which provide statutory procedures for ratifying and validating defective corporate acts. These statutory provisions eliminated the problems under prior case law in distinguishing between void and voidable corporate acts and the serious consequences created by corporate acts that were void and thus could not be subsequently ratified. The program will also cover the provisions of the Model Business Corporation Act (MBCA) and the common law of ratification in jurisdictions other than Delaware and discuss practice pointers and recent Delaware cases on ratification of defective corporate acts.

Identifying a “defective corporate act” and a “failure of authorization” are essential to understanding Sections 204 and 205. The program will explain the elements of a defective corporate act, the distinctions between “acts” and “intentions” and review the recent case law interpreting these concepts. The presenters will provide examples of defective corporate acts and provide practical guidance on how to ratify such defects under the Delaware statutory provisions and the comparable sections of the MBCA and will discuss recent judicial decisions in the area.

The program will also discuss how to determine whether the corporation has valid directors and a valid board and the quorum and voting requirements for ratification and how these requirements are interpreted and applied where the proposed ratification relates to the election of the initial board. The quorum and voting requirements are the greater of (i) those at the time of the act and (ii) those at the time of ratification, subject to certain specified exceptions such as the presence or approval of any director elected or appointed by the holders of any class or series where no shares of such class or series are outstanding at the time of ratification. The presenters will also discuss situations where defective corporate acts create uncertainty regarding board composition and whether to “fix” board composition before the board adopts the ratifying resolutions or later seek judicial validation under Section 205 or the comparable provision of the MBCA.

Stockholders must approve the ratification if the defective act would have required stockholder approval either at the time of the act or at the time of ratification. Stockholder ratification is required even if stockholder approval was correctly obtained in connection with the original act. In such cases, the stockholder vote that must be obtained is the greater of that required at the time of the act or at the time of the ratification, subject to certain specified exceptions, such as a series vote required at the time of the act where no shares of such series are outstanding at the time of the ratification. No stockholder vote is required, however, if there are no shares of valid stock outstanding as of the record date for determining stockholders entitled to vote on the ratification. The program will include a discussion of “valid stock” vs. “putative stock” and the In re Galena Biopharma case and “share tracing” issues.
Any act that would have required a filing with the Delaware Secretary of State for an initial defective act requires the filing of a certificate of validation. Generally speaking, a separate certificate of validation must be filed for each act, but one certificate can be filed for multiple over-issuances. If a certificate of validation is required, the company may also be required to file amended Delaware franchise tax reports for prior years and pay any “back” franchise taxes due as a result of retroactive changes to the number of authorized shares.

If the board has not fixed a future validation effective time in the manner permitted by Section 204(h)(6), the validation effective time will be the later of (i) the time at which stockholder approval is obtained or, if no stockholder approval is required, the time at which the board adopts the ratification resolutions; and (ii) the time at which any certificate of validation becomes effective. Where no certificate of validation is required to be filed, the board may specify a future effective time. A clean legal opinion as to a defective corporate act or putative stock may be given following the validation effective time. It is not necessary to wait for the expiration of the shortened, 120-day statute of limitations period. Under the MBCA, the validation effective time is the later of (i) the time at which the ratification of the defective corporate action is approved by the shareholders, or if shareholder approval is not required, the time at which the notice required by Section 1.49 becomes effective and (ii) the time at which any articles of validation filed in accordance with Section 1.51 become effective.

Notice of the ratification must be given to nonconsenting holders of valid or putative (including nonvoting) stock and also to former stockholders, as of the time of the defective corporate act (or record dates fixed therefor) unless the identities and addresses of such stockholders cannot be determined from the records of the corporation. Such notice must contain an express statement regarding the 120-day limitation period in which challenges must be brought.

The judicial validation procedures in Section 205 have been most frequently used as an “in court” alternative where the “self-help” procedures of Section 204 are not available. Section 205 also provides a mechanism to challenge a ratification effected pursuant to Section 204. MBCA Section 1.52 does not expressly enumerate the factors that a court may consider in proceedings brought under such section but provides that the court may take into account “any factors or considerations regarding such matters as it deems proper under the circumstances.”

Ratification under Section 204 or validation under Section 205 is not the exclusive means of ratifying or validating an act or transaction, and the absence or failure of ratification in accordance with Section 204 or validation under Section 205 does not, in and of itself, affect the validity or effectiveness of any act or transaction or the issuance of any stock properly ratified under common law or otherwise, nor does it create a presumption that any such act or transaction is or was a defective corporate act or that such stock is void or voidable.