

April 20, 2021

# Proposed California Legislation for Ratification and Validation of Noncompliant Corporate Acts

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The California State Legislature is considering legislation to authorize corporate ratification and judicial validation of noncompliant corporate actions (Senate Bill 218, as amended, the “*California Bill*”). The California Bill would provide for a new Section 119 to the California Corporations Code (the “*CCC*”) that is based on Section 78.0296 of the Nevada Revised Statutes (the “*Nevada Law*”) and Sections 204 and 205 of the Delaware General Corporation Law (the “*Delaware Law*”), while contemplating several variations including in the provisions for the scope of ratifiable corporate actions, retroactive effectiveness, shareholder notice, certificates of ratification and validation, and standing to petition a California court under the statute.

## Background regarding Ratification and Validation Statutes

As an historical matter, statutes for the ratification and validation of defective corporate acts began to arise when corporations found themselves unable to confidently rely on common law principles of ratification when they needed to shore up their corporate foundation or cure invalid stock. These difficulties often impinged on a corporation’s ability to obtain legal opinions, complete significant transactions, and quickly resolve questions about its capital structure or board composition.

The Delaware Law was adopted in 2013, followed by the Nevada Law. Since then, ratification and validation statutes have become more widely adopted by state legislatures and better understood through practice and litigation. The Delaware Law has been substantively addressed in litigation and practitioner commentary, as well as legislative amendments, which all make the Delaware Law uniquely well understood relative to other ratification and validation statutes. It is against this backdrop, and in the context of California’s importance as an incubator of emerging companies which frequently emerge as important players in the modern global economy after beginning on shoestring budgets that could make them susceptible to technical corporate foot faults, that the California State Legislature is considering the California Bill.

## Basic Framework of the California Bill

The California Bill is structured to provide ratification and validation in a fundamentally similar manner as the Nevada Law and the Delaware Law. Section 119(a) expressly provides that an

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otherwise lawful corporate action that may not have been effected in compliance with certain applicable requirements, including the CCC and the corporation's articles, may be ratified or validated under Section 119. Section 119(a) also makes clear that the statute is not limiting alternative means of ratification, validation, or correction, such as under common law or other sections of the CCC. Subdivision (g) expressly states that all corporate actions and equity ratified or validated in accordance with Section 119 can relate back to the date of the original corporate action. And subdivision (h) provides definitions of "corporate action" and "higher approval standard" as used in Section 119.

Subdivision (b) provides for approval of a ratification by the board and, in certain cases, shareholders pursuant to approval standards that would have applied to taking the underlying corporate action at the time of the corporate action and the time of the ratification. Subdivision (c) requires that notice of the ratification be sent after the ratification. Subdivision (d) provides for certificates of ratification that must be filed as part of a ratification with the California Secretary of State to ensure that the corporation's actions and records correspond to its filings with the state.

Subdivision (e) provides the California courts with broad jurisdiction to hear and address petitions regarding the validity of corporate actions and a corporation's equity. Subdivision (e) also provides broad standing for potentially interested parties to bring such a petition. Subdivision (f) provides for certificates of validation, which are similar in effect to certificates of ratification, but must be ordered by a California court to be filed with the California Secretary of State.

## Key Provisions of the California Bill

The California Bill also contains features that may deserve closer attention. The California Bill has been structured as a single section of the CCC and uses terminology and succinct phrasing that generally track the Nevada Law. The California Bill, however, has provided greater clarity and authority to California corporations and courts by incorporating variations on the Nevada Law, including legislative improvements adopted as part of the Delaware Law. One prominent theme running through the departures from the Nevada Law is the clarification of the contents of resolutions and certificates contemplated by the California Bill while remaining within the framework established by the Nevada Law. Indeed, in Senate committee commentary on the California Bill, it was noted that the California Bill is based on the Delaware Law, the Nevada Law, and similar statutes from other states. We would expect that Delaware case law regarding the Delaware Law will serve to assist practitioners in implementing the California Bill.

*Ratifiable Corporate Actions.* Section 119(a) tracks the Nevada Law by authorizing corporations to ratify corporate actions not in compliance with the CCC and the articles and bylaws of the corporation. However, dissolved corporations and foreign corporations are expressly excluded from exercising powers related to ratification and validation. The California Bill also ports additional explicit authority from the Delaware Law that expressly allows corporations to ratify corporate actions not in compliance with a plan or agreement to which the corporation is a party. Section 119(b) expands on the Nevada Law by specifying the contents of resolutions approving a ratification. Subdivision (b) addresses ratification of noncompliant corporate actions other than initial director

elections in a paragraph (b)(1) and ratification of initial director elections in a paragraph (b)(2), which is a similar structure to that of the analogous provisions in the Delaware Law. The explicit provision for the contents of ratification resolutions should be useful in preparing such resolutions and effecting a ratification.

*Retroactive Effectiveness.* Section 119(b) requires the ratification resolutions to state the date when the corporate action was intended to have been taken. This is also found in the Delaware Law, but subdivisions (b)(1)(B) and (b)(2)(B) permit the resolutions to fix an effective time for the ratified corporate action if it would be different than the time of the corporate action. Although the default under these provisions would fix the effective time of ratified corporate actions as the same as the intended time of the corporate action, the California Bill offers flexibility in this regard.

*Notice of Ratification.* Notice of a ratification effected under the California Bill is prescribed by Section 119(c). The notice must be sent to shareholders and holders of shares purportedly issued at the time of the ratification and, like the Nevada Law, the notice need not be sent to holders of validly or invalidly issued shares as of the time of the ratified corporate action. There are three aspects of this subdivision that draw on the Delaware Law and depart from the Nevada Law. First, notice must be given “promptly” after ratification, instead of within a specified period following approval of the ratification or validation. Second, a corporation is permitted to include the notice in its public company filings under the Securities Exchange Act of 1934, as amended. Third, notice is only explicitly required with respect to ratifications effected under subdivision (b), leaving open to the California court whether any notice will be required with respect to a petition or order under subdivision (e). We expect that these aspects of the California Bill should ensure efficient and appropriate compliance with notice requirements through provisions that resemble those adopted by other states.

*Certificates of Ratification and Certificates of Validation.* Certificates to be filed as part of a ratification or validation are described in Section 119(d) and (f), and are to be captioned as a certificate of ratification or certificate of validation depending on whether they are authorized by the corporation as part of a ratification under Section 119(b) or by a California court pursuant to a petition under Section 119(e). Drawing from the Delaware Law, the content of these certificates is expressly specified in Section 119(d) (with respect to certificates of ratification) and Section 119(f) (with respect to certificates of validation). As under the Nevada Law and the Delaware Law, these certificates may be filed in respect of a previously required instrument, which previous instrument may be amended, corrected, or unchanged, and in respect of an instrument that should have been but was not previously filed. Unlike the Delaware Law, multiple previous instruments may be ratified or validated by such certificates. Finally, like the Nevada Law, the California Bill expressly allows for a certificate of ratification or validation in respect of a previous instrument that would be caused by the certificate, when given effect, to become inaccurate or incomplete in any material respect. Section 119(d)(2) expressly acknowledges the authority of the California Secretary of State’s office to reject a certificate of ratification that would cause prior filings to become inaccurate, ambiguous, or unintelligible. In the event of such a determination, the corporation may need to seek validation of the related corporate actions. We would not expect these provisions to significantly alter use of

Section 119, as compared to the Nevada Law or the Delaware Law, except that these modifications provide clarification that may ease the processes for preparation and filing of a certificate of ratification or validation and flexibility that may allow corporations to limit the number of filings they must make with the state and avoid related filing fees.

*Jurisdiction of the California Courts.* Section 119(e) expressly provides for standing to petition a California court to determine and declare the validity of any corporate action or equity of a corporation and the date of its validity. In contrast to the Nevada Law, which provides standing to “any person adversely affected,” Section 119(e) (like the Delaware Law) provides standing for “any person claiming to be *substantially and* adversely affected” as well as the corporation, any successor entity, any director, and holders of valid and invalid shares as of the ratification or the noncompliant corporate action. To the extent that broad express judicial authority and the requirement that a petitioner under Section 119(e) be “substantially” affected prevents frivolous disputes and allows resolution of meritorious disputes, we would view that requirement as aligned with the intent of the California Bill to bring order and certainty to the capital structures and corporate foundations of California corporations.

## Conclusion

The adoption of the California Bill would mark an important development for California corporations, investors, and practitioners, and we await action by the California legislature and governor. We also expect interest from corporate practitioners in understanding the defining features of the California Bill, such as departure from fundamental elements of the Delaware Law and the Nevada Law.