

Ratification and Validation under New Section 119 of the California Corporations Code—A Practical Perspective

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A new Section 119 has been added to the California Corporations Code (the “CCC”). Section 119 provides for corporate ratification and judicial validation of noncompliant corporate actions, as an analogue to 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”). In a previous article, we provided an overview of the background, framework, and key provisions of Section 119 in a previous legislative session.¹ This article is intended to provide a practical perspective on the processes for implementing corporate self-help and seeking judicial relief under Section 119.

Needing a Ratification

Section 119 provides corporations and their shareholders with a more robust remedy for resolving void and voidable corporate issues than was previously available under California law.

Remediation of Noncompliant Corporate Actions. Rigorous application of corporate laws is intended to further the benefits of orderliness, certainty, and equity in the capitalization and transactions of

corporations. But such rigor can also result in defective shares and actions when directors, stockholders, and officers fail to comply with the required standards of authorization (including while acting in good faith). Historical options for remediation of invalidly authorized corporate actions, such as common law ratification, actions to quiet title, or a forward merger, were often found to be lacking where certainty and strict validity *ab initio* were needed. Discovery of a years’ old failure to comply with the statute could then spiral into significant questions about whether a corporation and its directors, stockholders, and officers in fact had the authority and interests that they were widely understood to possess. In a wide range of those situations, Section 119 allows corporations to ratify such actions with certainty and retroactivity.

Opinion Practice. An important impetus for Section 119 was to allow California corporations and investors to obtain legal opinions in connection with significant transactions. Because of the important role that legal opinions often play in corporate transactions, ratification and validation statutes have been enacted with the opinion perspective in mind. In practice, following an effective ratification

or validation (including the filing of any certificate of ratification or validation), the ratified or validated acts can be treated for corporate purposes as if they had been properly authorized and effected in the first instance. By reducing the risks and costs associated with legal opinions, Section 119 should also provide benefits by reducing closing risk and post-closing indemnity risk.

Framing a Ratification

The first step in using a ratification and validation statute is to place the problem in the framework of the statute. Although Section 119 and analogous statutes are intended to serve as flexible tools for fixing a broad range of corporate defects, there are limits to their application. Understanding those limits will help to determine whether the problem is susceptible of self-help ratification under Section 119.

Ratifiable Acts. A “corporate action,” which may be ratifiable under Section 119, is defined in Section 119(h)(1) as an act taken by directors, shareholders, or otherwise by or on behalf of the corporation. That is consistent with the Nevada Law and the

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Delaware Law, and the architecture of Section 119 is generally similar to that of the Nevada Law while incorporating clarifications from the Delaware Law. Given the similarities, we expect that a corporate action susceptible of ratification would be limited to acts actually intended to have been taken by or on behalf of the corporation, which is the way that Delaware courts have explained the limits on defective corporate acts under the Delaware Law. That would exclude acts that were not attempted, and for which no evidence exists, but may seem beneficial in retrospect. A corporate action may be ratified or validated if it may not have been taken in compliance with the CCC, the corporation's articles of incorporation or bylaws, or a plan or agreement to which the corporation was a party. Section 119(a), however, expressly carves out ratification and validation of corporate actions by dissolved and foreign corporations, and further excludes ratification and validation of corporate actions in respect of noncompliance with certain CCC provisions related to statutory fiduciary duties, interested transactions, distributions, repurchases, redemptions, and loans.

Delaware Precedent. We expect that Delaware case law and practitioner commentary regarding the Delaware Law will provide helpful and persuasive guidance when implementing Section 119. Of course, the precise terms of Section 119, as well as other provisions of the CCC and principles of California law, are paramount and may lead to different results than under the Delaware Law. Though much of Section 119 incorporates legislative improvements and more prescriptive provisions based on the Delaware Law and, combined with the guidance from Delaware courts (which makes the Delaware Law the only ratification and validation statute to have been so closely evaluated in litigation by the courts), we expect it will be appropriate for practitioners to use Delaware precedent as a reference when framing a potential

corporate ratification under Section 119. Indeed, legislative commentary on Section 119 has noted that Section 119 is based on the Delaware Law, the Nevada Law, and similar statutes from other states.

Documenting a Ratification

After a ratifiable noncompliant corporate action has been identified, the ratification must be effected and documented in accordance with Section 119. Subdivisions (b) and (d) provide the requirements for ratification resolutions and certificates of ratification, which are the key operative documents in such a ratification.

Ratification Resolutions. Section 119(b) requires the board of directors (and shareholders, as applicable) to adopt resolutions authorizing the ratification. Section 119(b) specifies the contents of resolutions approving a ratification, similarly to the Delaware Law. Ratification of noncompliant corporate actions other than initial director elections is addressed in paragraph (b)(1) and ratification of initial director elections is addressed in paragraph (b)(2), which is a similar structure to that of the analogous provisions in the Delaware Law. As a general matter, we expect that explicit provision for the contents of ratification resolutions should be useful to California corporations, practitioners, and investors in preparing such resolutions and understanding whether the ratification was properly effected.

Nature of Noncompliance. One of the items that must be included in resolutions under paragraph (b)(1) is the nature of the noncompliance. A corporate action may require ratification if it was not originally effected in compliance with applicable requirements. Section 119, like the Nevada Law, expressly permits ratification of a corporate act not in compliance with provisions of the statute and the corporation's articles of incorporation and

bylaws but, like the Delaware Law, also expressly allows California corporations to ratify corporate actions not in compliance with a plan or agreement to which the corporation is a party. Specifically, Section 119(b) requires the ratification resolutions to identify the "nature of the noncompliance or purported noncompliance." We expect that this phrase would be construed similarly to the "nature of failure of authorization" that must be identified under the Delaware Law.

In validation proceedings under the Delaware Law, Delaware judges have expected parties to identify the nature of the failure of authorization with reasonable specificity and completeness and suggested that validation would apply only to the extent that a failure of authorization was so identified. We have seen a similar standard applied in practice where Delaware corporations seek to provide a complete explanation why the original attempts to authorize the defective corporate act may have been inadequate under applicable requirements. We expect that best practice when describing the nature of the noncompliance in ratification resolutions will be to describe any requirement with which the original action failed to comply.

Retroactive Effectiveness. Another important component of the ratification resolutions contemplated by Section 119(b) is the effective time of a ratified corporate action. Section 119(b) requires the ratification resolutions to state the date when the corporate action was intended to have been taken and the 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, Section 119 offers flexibility in this regard. We expect that use of this flexibility will

generally have some nexus to the ratified corporate action and evidence of when it was attempted to be effected.

Certificate of Ratification. If a certificate was required to be filed with the California Secretary of State's office as part of the corporate action to be ratified, then the corporation must prepare a certificate of ratification as part of the ratification. That certificate would confirm that the ratification had been approved and set forth information specified by Section 119(d). 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. Section 119(d) provides added efficiency by allowing multiple previous instruments to be ratified by such certificates. That subdivision also allows the corporation to file a certificate of ratification 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. As a practical matter, however, counsel should anticipate possible delays in a ratification if it requires a certificate of ratification, because the California Secretary of State's office may not allow for preclearance or expedition of those filings.

Authorizing a Ratification

The final step of a ratification under Section 119 is obtaining approvals and giving notice under subdivisions (b) and (c). The standards and process applicable to authorization of a ratification are similar though not identical to those found in the Delaware Law and the Nevada Law.

Board Approval. Section 119(b) requires that all ratifications must be approved via adoption by the board of directors of the

ratification resolutions described above. The standard applicable to board approval is the approval standard that would apply to approval of the underlying corporate action at the time of the ratification. In addition, subdivision (h)(2) identifies higher approval standards in effect at the time of the original taking of the corporation action which, if applicable, must also be satisfied for board approval of a ratification. In light of the technical nature of a ratification under Section 119(b), the validity of the composition of the board of directors is often an initial question to consider before embarking on a ratification. When questions exist regarding the initial board of directors, Section 119(b)(2) sets forth provisions, analogous to those in the Delaware Law, for ratification of a corporate action related to the election of the initial directors. Finally, subdivision (i) confirms that the record-retention provisions of Section 1500 of the CCC apply to records related to a ratification or validation under Section 119.

Shareholder Approval. Ratification under Section 119 also requires shareholder approval to the extent that shareholder approval would have been required to authorize the type of corporate action in accordance with the CCC, articles of incorporation, bylaws, or a plan or agreement to which the corporation is a party in effect at the time of the ratification. A higher approval standard in effect at the time of the original taking of the corporation action may also apply to require additional votes for the ratification. The votes of shares issued pursuant to any corporate action being ratified are to be disregarded pursuant to subdivision (b)(1)(B) when determining the requisite vote or quorum. This is generally analogous to the Delaware Law and Nevada Law.

Shareholder Notice. Following a ratification effected under Section 119, subdivision (c)

calls for notice to be given to shareholders and holders of shares purportedly issued at the time of the ratification. Like the Nevada Law (and unlike the Delaware Law), there is no requirement that such notice be given to holders of shares as of the time when the corporate action was originally attempted. Notice must be given "promptly" after ratification and may be given by a public company in filings under the Securities Exchange Act of 1934, as amended. This notice begins a 180-day period, after which Section 119(e)(3) curtails the ability to file a petition with the California Superior Court relating to the ratification other than claims that the ratification failed to comply with Section 119. The analogous notice required by the Delaware Law is expressly required to contain certain statements regarding that limitation on judicial petitions relating to the ratification, but Section 119(c) tracks the Nevada Law in not prescribing the contents of this notice. Although disclosure, including with respect to the existence, duration, and effect of that period, can be part of an ideal process, we expect that this approach may be viewed as less of an incitement to potentially opportunistic or litigious shareholders and former shareholders.

Turning to the Courts

Section 119 provides for judicial remedies and jurisdiction related to noncompliance and the validity of corporate actions. Under the Delaware Law, parties have tended to pursue self-help options before resorting to the courts but the court has broad jurisdiction to hear petitions and validate actions that are not susceptible of corporate ratification. We see both policy bases for those approaches, and reasons why California courts may similarly construe the relevant provisions of Section 119.

Petition for Validation or Other Relief. To commence an action under Section

119(e), for the California Superior Court to determine or declare the validity of any corporate action or equity of a corporation, an authorized person must file a petition. Like the Delaware Law (and unlike the Nevada Law which provides standing to any person “adversely affected”), Section 119(e) provides standing for a 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. The Superior Court has broad authority under subdivision (e) to consider facts and circumstances and grant remedies as it finds appropriate. Subdivisions (e)(7) and (j) contain provisions requiring disclosure to ensure that the impact of action under Section 119 would be appreciated in any

legal proceedings where the validity of the underlying corporate action is potentially dispositive of that legal proceeding.

Certificate of Validation. Section 119(f) authorizes the Superior Court to order the filing of a certificate of validation in respect of a corporate action that is being validated and would have required the filing of an instrument with the Secretary of State. The contents and applications of a certificate of validation are generally similar to those of a certificate of ratification, except that the Superior Court authorizes the former and the corporation authorizes the latter.

Conclusion

Section 119 provides an important tool for remediation of noncompliant corporate

actions. We anticipate interest from corporate practitioners and stakeholders in understanding the defining features of this statute and look forward to its development including through commentary around implementation of the Delaware Law.

Endnote

- 1 Julia Reigel and Nate Emeritz, *Proposed California Legislation for Ratification and Validation of Noncompliant Corporate Acts*, Corporation Report Bulletin Headlines, Vol. XCII, No. 8, April 20, 2021. Although Section 119 largely reflects the legislation as described in our previous article, there have been amendments to the bill since publication of that article, some of which are mentioned in this article.