

Chapter 607 White Paper

Summary of Ratification of Defective Corporate Actions Proposed Legislation

Background

In 2013, the Delaware General Assembly amended the Delaware General Corporation Law (the "DGCL") to include new sections 204 and 205 which provided mechanisms for a practical way for a corporation to resolve defective corporate acts (including overissuances of shares) and other uncertainties facing corporations "without disproportionately disruptive consequences." In 2016, the Corporate Laws Committee of the American Bar Association approved the addition of sections to the Model Business Corporation Act ("MBCA") addressing ratification of defective corporate actions, in substantial part based on the DGCL provisions.

Provisions addressing ratification of defective corporate actions, other than the ability to utilize articles of correction, provide corporations with two alternative statutory paths to validate or ratify corporate actions, including overissuances of shares, that, due to a defect in authorization, may have been void and incapable of ratification. The first path involves remedial action taken by the corporation itself, through actions by its board of directors and, if required, its shareholders. The second path involves a court proceeding that can be initiated by the corporation or certain other interested constituencies. The provisions addressing ratification of corporate defective actions have not to this point been enacted in Florida. In an effort to conform with a growing number of states that have followed the DGCL and MBCA and enacted laws regarding ratification of defective corporate actions, the Chapter 607 Drafting Subcommittee is proposing that sections addressing these issues be added to Chapter 607, the Florida Business Corporation Act ("FBCA"). The proposed legislation is largely based on the MBCA, but also folds in certain aspects of the DGCL Sections 204 and 205.

Proposed Sections 607.0145-607.0152 provide a statutory ratification procedure for corporate actions that may not have been properly authorized and shares that may have been improperly issued. The statutory ratification procedure is designed to supplement common law ratification. Corporate actions ratified under these proposed provisions would remain subject to equitable review.

Examples of defective corporate actions subject to ratification under these proposed provisions include the failure of the incorporator to validly appoint an initial board of directors, corporate action taken in the absence of board resolutions authorizing the action, the failure to obtain the requisite shareholder approval of a corporate action, an issuance of shares in the absence of evidence that consideration payable to the corporation for shares was received, the failure to comply with appraisal requirements, an overissuance of shares that were not authorized prior to their issuance, and the issuance of shares without complying with preemptive rights. The ratification procedure is intended to be available only where there is objective evidence that a corporate action was defectively implemented. For example, these proposed provisions would permit ratification of shares previously issued but subsequently determined to have been issued

improperly. It would not permit the corporation to issue shares retroactively as of an earlier date, however, where there is no objective evidence that those shares had previously been issued. Objective evidence may include resolutions, issuance of share certificates, subscription or share purchase agreements, entries in a share ledger or other correspondence indicating that shares were issued or intended to have been issued.

I. General Provisions

(MBCA §§1.45 and 1.46, Proposed FBCA §§607.0145 and 607.0146)

These proposals substantially follow the MBCA. Many of the definitions in proposed §607.0145 were made intentionally broad so as to permit ratification of any corporate action that, except for the failure of the corporation to properly authorize the corporation, would have been within its power.

Proposed Sections 607.0145(3) and (5) – Definitions of “Defective Corporate Action” and “Overissue.” The term “defective corporate action” includes an “overissue” of shares and other defects in share issuances that could cause shares to be treated as void. For purposes of determining which shares are overissued, only those shares issued in excess of the number of shares permitted to be issued under s. 607.0601 of the FBCA would be deemed overissued shares. If it cannot be determined from the records of the corporation which shares were issued before others, all shares included in an issuance that is or results in an overissue would be overissued shares.

Proposed Section 607.0145(8) – Definition of “Validation effective time.” This proposed subsection departs from the MBCA in order to make it clear that if articles of validation (as set forth in subsequent sections) are required to be filed to complete the ratification of particular defective acts, the “validation effective time” will not occur until such filing is actually made in accordance with s. 607.0151.

Proposed Section 607.0146(1). This proposed subsection does not distinguish between “void” (per se invalid) or “voidable” (invalid upon challenge) actions. Instead, any defective corporate action that is ratified or validated under the proposed additions will not be considered to be void or voidable. In addition, this subsection expressly makes clear that effectiveness of the ratification of a defective corporate action in accordance with the requirements of s. 607.0147 requires compliance not only with that provision, but also requires the filing of articles of validation if such filing is required under s. 607.0151.

Proposed Section 607.0146(2). This proposed subsection makes it clear that the corporation's ratification of a voidable corporate action under existing common law precedent will continue to be valid, and that the provisions of this subsection are not the only way for a corporation to ratify a voidable corporate action. However, proposed Sections 607.0145-607.0152 are designed such that any ratification of defective corporate actions that are completed in accordance with such proposed sections would bring more certainty to the ratification process.

Proposed Section 607.1046(3). This proposed subsection provides that an overissue of shares over and above the number authorized in the corporation's articles of incorporation can be remedied by the adoption of an amendment to the articles of incorporation or other corporate action that authorizes or creates the putative shares that resulted in the overissuance. If the corporation does so, the shares are deemed to have been valid from the date of issuance. This provision enables a corporation to cure an overissue occurring when shares have been duly authorized but are issued before articles of amendment are filed. It also permits a corporation to remedy an overissue even if it cannot specifically identify the putative shares.

II. Procedures for Remedying Defective Corporate Acts (MBCA §§1.47-1.50, Proposed FBCA §§607.0147-607.0150)

These sections set forth the steps that (if the increased certainty provided in this proposed legislation is desired) must be used by a Florida corporation in order to remedy defective corporate actions.

Proposed Section 607.0147 (Ratification of Defective Corporate Actions). This proposed new section, based on Section 1.47 of the MBCA, sets forth the basic procedures by which a corporation can ratify void or voidable corporate actions.

Subsection 1. This proposed subsection, which is identical to Section 1.47(a) of the MBCA, sets forth the requirements for a board of directors to take any actions with regard to defective acts (other than the election of the board of directors itself, the procedures for which are set forth in subsection (2) below.) The information required by proposed subsection 607.0147(1)(a) regarding the listing of putative shares may be satisfied by attaching a table, including a capitalization table, listing the putative shares.

Subsection 2. This proposed subsection is also identical to the matching subsection of the MBCA, Section 1.47(b). The subsection eliminates the confusion with regard to defective appointment of a board of directors; that is, if the board of directors itself was not properly ratified, how can it take action to ratify itself? The subsection therefore allows for the board of directors, even if improperly appointed, to ratify its own defective appointment.

Subsection 3. This proposed subsection discusses instances where shareholder approval is required for ratification (for example, a defective issuance of shares requiring the amendment to the articles of incorporation to authorize additional shares or an additional class of shares, as opposed to a draw down by the board of directors under a properly authorized class of “blank check” preferred) and states that, after the board of directors takes action under subsection (1), it must refer the matter to shareholders in accordance with proposed section 607.0148 below.

Subsection 4. This subsection clarifies that the board of directors may abandon ratification even after approval without further action.

Proposed Section 607.0148 (Action on Ratification). This proposed new section is based on Section 1.48 of the MBCA and sets forth specific procedural requirements for the ratification of defective corporate actions.

Consistent with both Section 1.48 of the MBCA and Section 204 of the DGCL, notice is required to be provided to the holders of all shares, whether voting or non-voting. Further, consistent with both Section 1.48 of the MBCA and Section 204 of the DGCL, notice of the meeting or notice of the written consent, as the case may be, must be provided to both current shareholders of the corporation and shareholders who held shares as of the date of the occurrence of the defective corporate action. However, notice is not required to be given to persons who are no longer shareholders of the corporation at the time that the corporation is seeking ratification of the defective corporate actions but did not own their shares at the time of the defective corporate action (i.e., those who first acquired shares after the time of the defective corporate action, but disposed of all their shares by the time the corporation is seeking ratification of the defective corporate actions).

Subsection 1. This proposed subsection, based on Section 1.48(a) of the MBCA, states that that the quorum and voting requirements for an action taken by the board of directors under Section 607.0148(1) are subject to the same quorum and voting requirements for the same action set forth in the FBCA or the corporation's constituent documents taken in other circumstances. For example, if taking an action would require a supermajority to approve, it would also take a supermajority to ratify.

Subsection 2. This proposed subsection requires notice to be given to shareholders whether the defective corporate action is to be ratified at a meeting or by written consent.

Paragraph (a) of this proposed subsection, based on Section 1.48(b) of the MBCA, states that if ratification by shareholders is required and where approval is to be completed at an annual or special meeting of shareholders, the corporation must notify each owner of valid and putative shares, whether or not those shares are entitled to vote. The record date for any such meeting is deemed to be the date on which the defective action occurred. Notwithstanding, if the identity of holders of valid or putative shares cannot be determined from the records of the corporation, notice is not required. The proposed subsection also sets forth the notice requirements for any notices sent to shareholders under subsection (2) and states the materials and information that must accompany the notice.

Paragraph (b) of this proposed subsection, which is not in the MBCA, makes it express that if the defective corporate action is to be ratified by written consent, the corporation must notify each person who is a holder of valid and putative shares, regardless of whether entitled to vote, as of the record date for the action by written consent, and each person who is a holder of valid and putative shares, regardless of whether entitled to vote, as of the date of the occurrence of the defective corporate action. This is implied by the applicable provisions of the MBCA and the DGCL.

In both cases (i.e., meeting or written consent), the information required to be provided is the same.

Subsections 3 and 4. These proposed subsections are a mirror of subsection 1 relating to shareholders and are based on Sections 1.48(c) and (d) of the MBCA. Proposed subsection 3 states that the rule requiring that the same voting and quorum requirements remain in place, except where the action relates to the ratification of directors. Actions relating to directors are set forth in proposed subsection (4), which requires that each director receive more votes in favor of ratification than against be cast by shareholders at a meeting where a quorum is present and clarifies that, in the case of action taken by written consent of shareholders, the consents given favoring ratification by a voting group must represent a majority of the shares of such voting group.

Subsection 5. This proposed subsection is based on Section 1.48(e) of the MBCA and clarifies that putative shares existing on the record date are only entitled to notice of matters relating to ratification and that such shares are not entitled to vote, are not counted for quorum purposes, and are not counted in any written consent.

Subsection 6. This proposed subsection is based on Section 1.48(f) of the MBCA and clarifies that to ratify putative shares, whether by vote or by written consent, an amendment to the articles of incorporation must be approved.

Proposed Section 607.0149 (Notice Requirements). This proposed section and its subsections are based on section 1.49 of the MBCA and details notice requirements to shareholders and holders of putative shares when shareholder action to approve the ratification of the defective corporate action is not required. This proposed provision, like the corollary MBCA provision, contemplates "prompt" notice to shareholders following the ratification of a corporate action by the board of directors, which is intended to mean as soon as reasonably practicable under the applicable facts and circumstances.

Unlike s. 607.0704(7) of the FBCA, this section does not state that the failure to provide the notice does not invalidate the action taken. This is intended to make clear that to take advantage of the statutory ratification provisions in this proposed statute, the required notice must be given to shareholders and putative holders. It should be recognized that where the notice is required, the validation effective time will not occur until the notice is given, or if also required, the articles of validation are filed, if later.

Subsection 1. Where shareholder action on ratification is not required, a corporation must provide prompt notice to each shareholder (including to each putative shareholder) regarding the date of action and the date of the ratification.

Subsection 2. If notice is given under proposed subsection 1, this proposed subsection sets forth the content of the required notice. This includes (i) a copy of the action taken by the board of directors (ii) the information required by proposed subsections 607.0147(1)(a) through (1)(d) or proposed subsections 607.0147(2)(a) through (2)(c), as applicable and (iii) a statement that a claim asserting that ratification of the

defective corporate action (including any putative shares issued thereby) should not be effective must be brought within 120 days from the applicable validation effective time.

Subsection 3. Clarifies that if notice is given under proposed subsection (2), no additional notice is required for shareholder approval. This is because the information contemplated by the notice is already required to be provided in the notice of any shareholder meeting or in connection with the solicitation of written consents of shareholders.

Subsection 4. Clarifies that any notice under this proposed section may be given in any manner required under existing section 607.0141 of the FBCA, and, in the case of a public company, notice may be given by means required by the United States Securities and Exchange Commission.

Proposed Section 607.0150 (Effect of Ratification). This proposed section and its subsections are based on section 1.50 of the MBCA and set forth specifics on how ratification, upon proper notice, affects the corporation and the timing of any ratification. Ratification is effective as of the validation effective time and is not dependent on the expiration of the 120-day time period in which an action challenging the ratification must be brought.

Subsection 1. Where a defective corporate action is properly ratified, it is deemed no longer void or voidable and is deemed for all intents and purposes to be a validly approved corporate action, effective as of the date of the original defective act.

Subsection 2. Similarly, issuances of putative shares, or fractions of a putative share, as the case may be, are deemed to be issuances of identical valid shares, or fractions of shares, on the date on which the putative share or fraction of a putative share was purportedly issued (as if it were issued back when it was originally purportedly issued).

Subsection 3. Any actions taken subsequent to the initial defective corporate action, but before the ratification thereof, are also deemed to be valid, as of the date the original action was taken. In other words, the ratification of a defective corporate action has the additional effect of ratifying corporate actions that are defective because of the original defective corporate action. For example, an overissue which results in subsequent director elections being invalid calls into question all actions by the invalidly elected board members. The ratification of the overissue, however, would cure any such additional defects.

III. Filings (MBCA §1.51, Proposed FBCA §607.0151)

This proposed section sets forth requirements for filings both where filings were not made and where they were made incorrectly, and is intended to provide a clear public record of the actions relating to the ratification. This proposed section and its subsections are based on Section 1.51 of the MBCA. Proposed section 607.0151 requires that in the event any filing is or would have been required under the FBCA to effect the defective corporate action, such filing (if

no filing was previously made) or such corrected filing (if correction to a previous filing is required) be attached as an exhibit to the articles of validation.

Consistent with recent changes to Section 204 of the DCGL, this proposal eliminates the required filing of articles of validation if changes to the previous filing made with the Florida Department of State are not required in order for the prior filing to be accurate following the ratification. The MBCA does not eliminate that requirement.

Subsection 1. Where a filing would have been required for the ratified defective corporate action, regardless of whether or not such filing was properly made, a corporation must file articles of validation with the Florida Department of State, which serves to amend, or serves as a substitute for, any filings related to the defective corporate action.

Subsections 2 and 3. Like their MBCA counterparts, these subsections set forth requirements for the content of articles of validation filings with the Florida Department of State.

IV. Judicial Proceedings. (MBCA §1.52, Proposed FBCA §607.0152)

This section confers jurisdiction on the designated court to hear and determine claims regarding the validity of any corporate action. Subsections 1-4 are based on subsections (a)-(d) of Section 1.52 of the MBCA.

Subsection 1. A corporation or successor thereto, a director of a corporation, or any shareholder of the corporation may apply to a court to determine the validity of any corporate action (or ratified defective corporate action).

Subsection 2. When an application is made under subsection 1, the court may make any findings or orders it deems proper under the circumstances.

Subsection 3. Clarifies that service of process for any such proceeding is the same as that of any proceeding as set forth in Chapter 48, Florida Statutes.

Subsection 4. Any action taken must be brought within 120 days of the "validation effective time", as defined in proposed section 607.0145(8).

Proposed subsections 5 and 6 are not a part of the MBCA. However, they are derived from the DCGL and are being suggested by the Chapter 607 Drafting Subcommittee in order to give additional guidance to the courts.

Subsection 5. In an effort to assist the court, this proposed subsection sets forth a non-exclusive list of various factors that may be considered by the court with respect to cases brought under this proposed section.

Subsection 6. In order to assist the court, this proposed subsection sets forth certain actions that the court may decide to take, including declaring any acts to be effective or ineffective as well as the date of validity. Proposed subsection (6)(j) allows for the awarding of attorney's fees and other reasonable expenses against a corporation where the court finds such award to be just and equitable under the circumstances.