

# PERSPECTIVE ON THE NEW CALIFORNIA RATIFICATION LAW BASED ON CALIFORNIA CORPORATE AND DELAWARE RATIFICATION PRACTICES

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California has adopted a ratification and validation statute, section 119 of the California General Corporation Law (“GCL”) (Cal. Corp. Code § 119), which became effective January 1, 2023.<sup>01</sup> Section 119 provides for corporate ratification and judicial validation of noncompliant corporate actions, as an analogue to sections 204 and 205 of the Delaware General Corporation Law (Del. Code Ann. tit. 8, §§ 204–205, referred to herein collectively as the “Delaware Law”). Based on our experience with the GCL, the Delaware Law, and relevant California and Delaware case law, this article is intended to provide thoughts for consideration regarding the development of law and practice around section 119.

## CONTEXT FOR SECTION 119 AND STATUTORY RATIFICATION

Section 119 has been added to the GCL to address shortcomings regarding common law ratification as a remedy for resolving void and voidable corporate issues.<sup>02</sup> Following Delaware’s adoption of the Delaware Law in 2013, other states enacted similar statutes for corporate ratification and judicial validation of invalid corporate actions.<sup>03</sup> Although these statutes reflect a range of policy and drafting choices, they also reflect similarity in the underlying issues being addressed and primary operative features. We expect that an understanding of the Delaware Law will, therefore, be

critical to informing implementation, interpretation, and development of section 119.

### ***Noncompliant Corporate Actions in California Corporate Practice.***

A “corporate action,” which is susceptible of ratification under section 119, is an act taken by directors, shareholders, or otherwise by or on behalf of the corporation, which was not taken in compliance with the GCL, the corporation’s articles of incorporation or bylaws, or a plan or agreement to which the corporation was a party. In corporate practice under California law, noncompliant corporate actions have presented serious issues for a corporation needing to make representations or obtain legal opinions regarding its corporate and capital structures in connection with a significant transaction. In a report on legal opinions, a committee of the California Lawyers Association explained the problems created by noncompliance for “valid issuance” and “due authorization” opinions regarding a corporation’s capital structure:

The “validly issued” opinion cannot properly be given if the shares were issued without proper board or shareholder approval, in violation of any shareholders’ preemptive rights set forth in the articles, or in excess of the number of authorized shares. While this Report maintains

a distinction between the “due authorization” and “validly issued” opinions, an opinion giver should not render a “validly issued” opinion if the opinion giver could not also give the “duly authorized” opinion (or appropriately rely on an assumption or an opinion of other counsel as to due authorization), whether or not requested to do so.<sup>04</sup>

Subject to the limitations in opinion giving set forth below, section 119 offers a path forward in such circumstances, which is critical because California law has previously offered few satisfactory approaches to remediating noncompliant corporate actions.

California common law may be inadequate to the task of ratifying void actions, such as a noncompliant stock issuance. Practitioners have used forward mergers to provide an arguably clean corporate slate by establishing a new entity or exchanging shares by operation of the California merger statute. There is uncertainty, however, whether that approach eliminates the taint of invalidity permeating the constituent corporation and its authorization of the merger, even with releases by shareholders and putative shareholders. Corporations have also petitioned the courts to quiet title as to noncompliant actions or stock, but that approach focuses on litigation risk and not remediation of any noncompliance or defective authorization. Indeed, it was similar issues that caused Delaware and other states to adopt corporate ratification and judicial validation statutes.<sup>05</sup> Accordingly, the touchstones for an effective ratification regime under both the Delaware Law and section 119 are to ensure, to the greatest extent possible, certainty, retroactivity, and equity.

#### ***Ratification and Validation Precedent in Delaware Practice.***

As a general matter, Delaware courts have issued decisions under the Delaware Law containing important insights and interpretive guidance that has greatly advanced the Delaware Law from a novel statute to a more widely understood and useful tool for Delaware corporate practitioners and stakeholders. In light of the relative complexity of ratification and validation statutes like section 119 and the similarities of section 119 to the Delaware Law, Delaware case law and practitioner commentary regarding the Delaware Law will provide helpful and persuasive guidance when implementing section 119. There are important distinctions between section 119 and the Delaware Law, as well as between Delaware and California statutory and common law regarding corporations, and those distinctions must be taken into account when considering the applicability of precedent related to the Delaware Law. But legislative commentary on section 119 states that section 119 is

based on the Delaware Law and similar statutes from other states, which supports use of the Delaware Law as an appropriate source of guidance.

## **FOUNDATIONAL MATTERS OF RATIFICATION**

Ratification and validation statutes build on a few foundational elements, which limit the scope of the statute, confirm its powerful effect within that limited scope, and provide an essential path for remediation of noncompliant corporate actions. Because these foundational elements apply to both the Delaware Law and section 119, it is appropriate that they result in similar application, interpretation, and development of the prerequisites, effect, and procedure for ratification. Because corporate ratification and judicial validation statutes have been around for less than a decade, experience and precedent from the Delaware Law provide a distinct advantage for understanding section 119 that may help to ensure that its powerful effect is directed toward the intended equitable purposes.

***Prerequisites to Statutory Ratification.*** A Delaware corporation intending to ratify a defective corporate act under the Delaware Law is expected to be validly existing and have a validly constituted board of directors as of the time that the board adopts resolutions approving the ratification.<sup>06</sup> In some circumstances, a certificate of correction or other measures may be available to shore up the validity of the corporate existence or board.<sup>07</sup> When the corporation cannot establish that it is validly existing and has a validly constituted board, however, the corporate ratification procedures will be unavailable and it will be necessary to petition the court for judicial validation.

The scope of ratifiable corporate actions under the Delaware Law has also been circumscribed by case law. Only acts that were actually attempted to be taken may be ratified, while mere “watercooler talk” in contemplation of a corporate act is not ratifiable.<sup>08</sup> The Delaware Law, therefore, may not be used to retroactively effect a corporate act that certain individuals wish that they had done or attempted but knew that they had not. In addition, only corporate acts that were within the power of the corporation at the time of the attempted act and the time of the ratification, are susceptible of ratification under the Delaware Law.<sup>09</sup>

In light of the similarities of section 119 and the Delaware Law, we expect that these foundational matters will similarly apply to section 119. Section 119(a)(4) and (5) further expressly prohibit ratification and validation of corporate actions (i) by dissolved and foreign corporations or (ii) in respect of noncompliance with certain GCL

provisions related to statutory fiduciary duties, interested party transactions, distributions, repurchases, redemptions, and loans. These limits effectively track similar limits on the Delaware Law.

**Principles of Statutory Ratification.** The corporate power established under section 119 closely resembles that established under the Delaware Law, and like the Delaware Law we expect that section 119 will be construed to provide California corporations with broad and constructive power to remediate noncompliant corporate actions. Indeed, Delaware case law recognizes that the corporate ratification and judicial validation powers are sufficiently broad that they could potentially lead to ratification or validation of a defective corporate act over the objection of the corporation,<sup>10</sup> and that corporations can obtain broader relief from the court than is available under the self-help provisions.<sup>11</sup>

Following authorization and notice of a ratification under the Delaware Law, the ratified corporate act is given certain and retroactive validity. Likewise, section 119(g) provides that a ratified corporate action relates back to the date of the original corporate action, and sections 119(b) and (e) further permit ratified corporate actions to be made effective as of a date other than the date of the original corporate action. The Delaware courts have also recognized, however, that ratification power is intended to be used constructively to cure inadvertent and good faith missteps<sup>12</sup>—and not to invalidate otherwise valid actions,<sup>13</sup> to provide a windfall,<sup>14</sup> or to avoid fiduciary duties.<sup>15</sup>

In the context of litigation over defective corporate acts, the Delaware Law has been used to provide a corporate benefit<sup>16</sup> and to moot litigation claims.<sup>17</sup> We expect that section 119 may be used for a similarly beneficial effect. Section 119(e)(7), however, requires a validation petition to identify other proceedings related to the noncompliant corporate action, and section 119(j) requires notice to the tribunal if a corporate ratification or validation in another proceeding would result in the dismissal of the proceeding in front of the tribunal.<sup>18</sup>

**Process For Statutory Ratification.** The process for ratification is laid out in section 119(b), and it closely tracks the Delaware Law process.<sup>19</sup> The board of directors first adopts detailed resolutions identifying the noncompliant corporate action, including the nature of the noncompliance, which is analogous to a failure of authorization under the Delaware Law. Delaware case law indicates that a validation is only effective with respect to failures of authorization that are identified to the court, and we expect that the same principle would apply to ratifications under section 119.<sup>20</sup>

Following board adoption of the ratification resolutions, notice must be given to shareholders as of the time of the ratification under section 119(c). In two departures from the Delaware Law, section 119(c) does not require the corporation to give notice to any shareholders who were shareholders as of the original corporate action but not as of the time of the ratification, nor does it prescribe the contents of that notice. Because this ratification notice begins a 180-day limitations period on actions to challenge the ratification in California Superior Court under section 119(e)(3), we believe it is advisable to provide a description of these rights and limits to shareholders, similar to what is required by the Delaware Law.

Shareholders must also approve the ratification resolutions if shareholder approval would have been required at the time of the original corporate action or to take such a corporate action at the time of the ratification. The quorum and voting standards applicable to these resolutions are the same as those applicable to the original corporate action and such a corporate action at the time of the ratification. In addition, the corporation must file a certificate of ratification in respect of the noncompliant corporate action if that corporate action required a filing with the California Secretary of State in the first instance. A certificate of ratification must contain the information specified in section 119(d), which is similar to the information contained in the ratification resolutions, as well as either confirmation that a previously filed certificate is to be unchanged, or an amendment, correction, or refile of the prior certificate. Unlike the Delaware Law, a certificate of ratification under section 119 may be filed in respect of more than one prior article of incorporation or certificate of amendment.

Section 119(e) provides broad authority and jurisdiction for the California Superior Court to hear petitions brought by the corporation or a successor entity, its directors and shareholders, or a person substantially and adversely affected, challenging a ratification or seeking validation of corporate actions. This breadth mirrors the Delaware Law, as does the California court's ability to consider facts and circumstances and fashion remedies that it views as appropriate. This broad judicial authority provides an important check on the broad corporate power of ratification. Under the Delaware Law, parties typically attempt a "self-help" corporate ratification before seeking assistance from the courts, although the Delaware Court of Chancery has acknowledged that the Delaware Law does not require exhaustion of remedies as a predicate to filing a validation petition.<sup>21</sup> As a matter of equity and prudent use of judicial resources, we believe that a similar approach to section 119(e) would be appropriate. One technical difference between the Delaware Law and the judicial validation provisions of section 119 is that section

119(f) contemplates a certificate of validation in lieu of a certificate of ratification for noncompliant corporate actions that require a filing with the California Secretary of State and are validated by the California Superior Court.

## CERTAIN PRACTICE ISSUES

The foregoing provides a brief overview of the key features of section 119 and the lessons that may be gleaned from analogous provisions of the Delaware Law. There are two areas of consideration, however, that we would like to highlight. First, use of a ratification and validation statute in the context of litigation raises interesting issues and occasionally creative tactics. In our view, the Delaware courts have dealt with these situations in appropriate ways, which we highlight and place in the context of section 119. Second, ratification and validation are often effected with an eye toward enabling the giving of legal opinions, and there are important differences between section 119 and the Delaware Law in that regard.

**Litigation Concerns.** As noted above, one benefit of the Delaware Law has been its use to moot litigation by resolving an underlying defective corporate act. In a similar situation in California, however, section 119(j) requires the corporation to notify the tribunal at least 10 days before adopting ratification resolutions or filing a validation petition that would result in the dismissal in whole or in part of the proceeding. Upon receipt of that notice, the tribunal is expressly authorized to stay the ratification or validation in accordance with the interests of justice and equity. Although this notice should merely serve to maintain the orderly administration of litigation proceedings and corporate actions occurring in parallel, it does create an additional logistical issue for counsel to keep in mind.

Delaware courts have also put in place firm guardrails to prevent opportunistic litigation under the Delaware Law. Those guardrails include case decisions that stockholders should be incentivized to identify and seek validation of defective corporate acts,<sup>22</sup> that corporations and stockholders who are uncooperative with ratification and validation efforts will not be countenanced,<sup>23</sup> that relief granted under the Delaware Law will be limited to the facts and information presented to the court,<sup>24</sup> and that the court will review actions under the Delaware Law for compliance with legal and equitable principles.<sup>25</sup> We expect that, by adopting similar positions on section 119, the California Superior Court can send a strong message that section 119 is to be used for constructive means in the best interests of the corporation and not for self-serving mischief.

**Legal Opinions.** Part of the impetus for ratification and validation statutes is to provide an efficient path for outside counsel to give legal opinions related to significant corporate transactions. Following enactment of the Delaware Law, practitioners concluded that ratification or validation under the Delaware Law would permit counsel to give a legal opinion with respect to the matters that had been ratified or validated.<sup>26</sup> Although the ratification and underlying ratified corporate actions remain subject to challenge under the validation statute and other legal theories, those ratified corporate actions are in that sense no different than other corporate actions that could potentially be the subject of litigation claims. Once a noncompliant corporate action has been ratified or validated under section 119 (including the filing of any certificate of ratification or validation), we would likewise expect similar opinion-giving practices to be adopted with respect to the ratification or validation.<sup>27</sup>

Because of the GCL provisions regarding fiduciary duties, including the prohibition under section 119(a)(5) against ratification of noncompliance with those fiduciary duty provisions, the standard carve out in legal opinions for fiduciary duties is both appropriate and important.<sup>28</sup> However, we view section 119(a)(5) as narrowly proscribing ratification or validation solely with respect to the specified noncompliance. For example, if a director breached his or her fiduciary duties when approving a corporate action that was not in compliance with another requirement of the GCL or the corporation's articles of incorporation, bylaws, plan, or agreement, the corporation could use section 119 to ratify or petition the Superior Court to validate that corporate action in respect of the other noncompliance. The concern with mischief or abuse of section 119 is addressed by the fact that such a ratification or validation would remain subject to the court's broad jurisdiction under section 119(e), including the court's ability to consider legal and equitable remedies. Following that ratification or validation, counsel could give a legal opinion regarding that corporate action with a typical carve out for any breach of fiduciary duty.

We also note that the practice under the Delaware Law, whereby legal opinions that depend on the effectiveness of a certificate of validation are not given until that certificate has been accepted for filing by the Delaware Secretary of State, is no less important under section 119. Indeed, section 119(d)(2) expressly permits the California Secretary of State, in its discretion, to reject a certificate of ratification if it would render prior filings with the California Secretary of State inaccurate, ambiguous, or unintelligible. Although we believe that authority to reject a certificate of ratification will be used sparingly, it is a broad discretionary power that could potentially derail an

otherwise authorized ratification. Accordingly, practitioners should not treat ratifications requiring a certificate of ratification as complete until that certificate has been accepted for filing. As the California Secretary of State has currently suspended preclearance, practitioners should consider the timing implications of the need to obtain the stamped certificate of ratification or validation before issuing an opinion.

## CONCLUSION

Section 119 is a powerful new GCL tool that can be used to greatly benefit corporations, investors, and other stakeholders. Although the application and interpretation of section 119 will chart its own path, experience from the Delaware Law is likely to provide valuable guidance to ensure such benefits and avoid mischievous use of section 119.

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- 01 SB 218 Corporations: ratification or validation of noncompliant corporate actions, available at [https://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill\\_id=202120220SB218](https://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill_id=202120220SB218).
- 02 SB 218 was signed into law on August 29, 2022.
- 03 See Nate Emeritz, *The Development of Statutes for Ratification and Validation of Defective Corporate Acts*, Harvard Law School Forum on Corporate Governance (July 28, 2019), available at <https://corpgov.law.harvard.edu/2019/07/28/the-development-of-statutes-for-ratification-and-validation-of-defective-corporate-acts/>. Since that article, other states such as Maryland have adopted ratification and validation statutes.
- 04 Corporations Committee of the Business Law Section of the California Lawyers Association, *2005 Opinions Report: Legal Opinions in Business Transactions* (October 2007 Printing as revised), available at <https://calawyers.org/business-law/corporations-committee-2005-opinions-report-legal-opinions-in-business-transactions-october-2007-revision/>.
- 05 See C. Stephen Bigler and John Mark Zeberkiewicz, *Restoring Equity: Delaware's Legislative Cure for Defects in Stock Issuances and Other Corporate Acts*, 69 Bus. Law. 393 (2014) ("Restoring Equity").
- 06 *Restoring Equity*, at 405.
- 07 *Id.* See also Del. Code Ann., tit. 8, § 204(b)(2) (setting forth the procedure for ratifying a defective corporate act in respect of the election of the initial board of directors).
- 08 *In re Numoda Corp.*, 128 A.3d 991 (Del. 2015); *In re Baxter Int'l Inc.*, C.A. No. 11609-CB (Del. Ch. Jan. 15 & June 22, 2016) (TRANSCRIPTS) (MOTION FOR ORDER UNDER SECTION 205 OF THE DELAWARE GENERAL CORPORATION LAW).
- 09 *Applied Energetics, Inc. v. Farley*, 239 A.3d 409 (Del. Ch. 2020).
- 10 *Knoll Capital Mgmt. L.P. v. Advaxis, Inc.*, C.A. No. 11417-VCN, 2016 Del. Ch. LEXIS 17 (Del. Ch. Jan. 29, 2016).
- 11 *In re Trupanion, Inc.*, C.A. No. 9496-VCP (Del. Ch. Apr. 28, 2014) (TRANSCRIPT) (MOTION FOR RELIEF UNDER 8 DELAWARE CODE SECTION 205).
- 12 *In re Cheniere Energy, Inc.*, 2015 WL 2207017 (Del. Ch. Mar. 16, 2015).
- 13 *Genelux Corp. v. Roeder (In re Genelux Corp.)*, 126 A.3d 644 (Del. Ch. 2015).
- 14 *CertiSign Holding, Inc. v. Kulikovsky*, C.A. No. 12055-VCS, 2018 Del. Ch. LEXIS 185 (Del. Ch. June 7, 2018); see also *Almond v. Glenhill Advisors LLC*, C.A. No. 10477-CB, 2018 Del. Ch. LEXIS 280 (Del. Ch. Aug. 17, 2018), aff'd 224 A.3d 200 (Del. 2019) ("*Design Within Reach I*").
- 15 *CertiSign Holding*.
- 16 *In re Colfax Corporation*, C.A. No. 10447-VCL (Apr. 2, 2015) (TRANSCRIPT) (MOTIONS FOR JUDGMENT ON THE PLEADINGS AND FOR AWARD OF ATTORNEYS' FEES AND EXPENSES); cf. *Almond v. Glenhill Advisors LLC*, CA No. 10477-CB, 2019 Del. Ch. LEXIS 124 (Del. Ch. Apr. 10, 2019) ("*Design Within Reach II*").
- 17 *Colfax*.
- 18 Although the Delaware Court of Chancery Rules broadly require all complaints (including those filed under section 205 of the Delaware General Corporation Law (Del. Code Ann. tit. 8, § 205)) to identify "related cases" on an ancillary form called a Supplemental Information Sheet, statements made on that form are expressly non-binding and for administrative purposes only, and no Delaware analog to the statutory requirement found in section 119(e)(7) of the GCL exists.
- 19 For further discussion of the procedure for a corporate ratification under section 119, see Julia Reigel and Nate Emeritz, *Ratification and Validation under New Section 119 of the California Corporations Code—A Practical Perspective*, Corporation Report Bulletin Headlines, Vol. XCIII, No. 18, September 15, 2022.
- 20 See *Trupanion*.
- 21 *In re 1847 Goedeker Inc.*, Consol. C.A. No. 2022-0219-SG (May 27, 2022) (TRANSCRIPT) (MOTION FOR ENTRY OF AN ORDER UNDER 8 DEL. C. S. 205).
- 22 *Colfax*.
- 23 *Colfax; CertiSign Holding; Design Within Reach II*.
- 24 *Trupanion*.
- 25 *CertiSign Holding*.