

Department of Legislative Services
Maryland General Assembly
2022 Session

FISCAL AND POLICY NOTE
Third Reader - Revised

House Bill 996

(Delegate Brooks)

Economic Matters

Judicial Proceedings

Corporations and Associations - Ratification of Defective Corporate Acts

This bill establishes a process by which a corporation may ratify a “defective corporate act” and, among other provisions, specifies that a defective corporate act that is ratified in accordance with the bill’s requirements is not void or voidable as a result of an identified failure of authorization. The bill authorizes a court to determine the validity of any ratification and to modify or waive the bill’s ratification procedures. The bill further specifies that its requirements may not be construed to be the exclusive means of ratifying or validating a defective corporate act, nor may the absence or failure of ratification in accordance with the bill create a presumption that any corporate act is or was a defective corporate act or void or voidable. In addition, the bill sets requirements for filing articles of validation relating to a defective corporate act with the State Department of Assessments and Taxation (SDAT).

Fiscal Summary

State Effect: General fund expenditures increase by \$278,400 in FY 2023 for one-time SDAT programming costs. Potential minimal increase in filing fee revenues. State finances and operations are not otherwise materially affected.

(in dollars)	FY 2023	FY 2024	FY 2025	FY 2026	FY 2027
Revenues	\$0	\$0	\$0	\$0	\$0
GF Expenditure	278,400	0	0	0	0
Net Effect	(\$278,400)	\$0	\$0	\$0	\$0

Note: () = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate increase; (-) = indeterminate decrease

Local Effect: The bill is not expected to materially affect the operations or finances of the circuit courts.

Small Business Effect: Minimal.

Analysis

Bill Summary:

Select Definitions

“Defective corporate act” means (1) any corporate act purportedly taken that, at the date of the defective corporate act, would have been within the power of the corporation but is void or voidable due to a failure of authorization or (2) an overissue (of stock, as specified). “Date of the defective corporate act” is also a defined term.

“Failure of authorization” means the failure of a corporation to authorize, approve, or otherwise effect a corporate act in compliance with the Maryland General Corporation Law, its charters or bylaws, any action taken by its board of directors, a committee of its board of directors, or its stockholders, or any plan or agreement to which the corporation is a party, if and to the extent that the failure would render the corporate act void or voidable.

“Putative stock” means stock, including stock reissued upon exercise of rights, options, warrants, or other securities convertible into or exercisable for stock (1) purportedly created or issued as a result of a defective corporate act, that but for the failure of authorization would constitute valid stock and (2) that cannot be determined by the board of directors to be valid stock.

Ratification of a Defective Corporate Act

The bill authorizes a corporation’s board of directors to ratify a defective corporate act by adopting a resolution stating (1) the defective corporate act to be ratified and, if the defective corporate act involved the issuance of putative stock, the number of shares and the class or series of putative stock issued; (2) the date of the defective corporate act; (3) the nature of the failure of authorization of the defective corporate act; and (4) depending on whether the board of directors could have authorized or approved the defective corporate act without stockholder approval (and whether stockholder action is required as of the date of ratification), either that the board ratifies the defective corporate act or directs that the ratification be submitted for consideration at a stockholders’ meeting. If ratification is submitted for consideration at a stockholders’ meeting, the stockholders may ratify the defective corporate act by adopting a resolution, as specified.

The quorum and voting requirements applicable to ratification must be the approval standard requiring the greater portion of votes under (1) the requirements that would be applicable to the defective corporate act proposed to be ratified at the time of ratification or (2) the requirements that would have been applicable to the defective corporate act on

the date of the defective corporate act. Unless otherwise required by the charter or bylaws of a corporation then in effect or in effect at the time of a defective corporate act, if the defective corporate act is the election of a director, ratification of the defective corporate act must require a majority of the votes cast at a meeting at which a quorum is present. The presence or approval of holders of stock of any class or series of which no stock is then outstanding or of any person that is no longer a stockholder may not be required. Holders of putative stock on the record date for determining which stockholders are entitled to vote on a ratification submitted to stockholders under these provisions must not be entitled to vote or be counted for quorum purposes in any vote to consider ratification. The bill further specifies requirements governing the manner of notice that must be provided to stockholders in order to ratify a defective corporate act.

Ratification of a defective corporate act makes the ratified defective corporate act binding on the corporation. Ratification of a defective corporate act becomes effective on the date that the board of directors or stockholders adopts a resolution, as described above. However, if the defective corporate act would have required a filing with SDAT, ratification of the defective corporate act becomes effective on the later of (1) the date that articles of validation are accepted for record by SDAT or (2) the date established in the articles of validation, not to exceed 30 days after the articles are accepted for record.

Beginning at the time ratification is effective, and without regard to the 120-day period (discussed below) during which a claim may be brought, (1) a defective corporate act that is ratified in accordance with the bill's requirements is not void or voidable as a result of an identified failure of authorization and must be deemed a valid corporate act effective as of the date of the defective corporate act; (2) the issuance of putative stock purportedly issued pursuant to an identified defective corporate act is not void or voidable and must be deemed valid stock as of the time it was purportedly issued; and (3) any corporate act taken (after ratification of a defective corporate act) in reliance on the defective corporate act having been validly effected, and any subsequent defective corporate act resulting from the original defective corporate act, is valid as of the time the act was taken.

Articles of Validation

If a ratified defective corporate act would have required the filing of a charter document with SDAT, the corporation must file articles of validation with SDAT that include (1) the title and date of filing of any charter document previously filed with respect to the defective corporate act and any charter document that amended, supplemented, or corrected that charter document; (2) a statement describing the defective corporate act; (3) the date of the defective corporate act; (4) a statement that the defective corporate act was ratified in accordance with the bill's requirements and a description of the ratification; (5) the time that the ratification is to become effective; and (6) a statement as to whether a charter document was previously filed with respect to the defective corporate act, what changes (if

any) are being made to the charter document, and any other required information. The nonrefundable processing fee for articles of validation is \$100. The bill also makes conforming changes relating to the execution of articles of validation.

Authorization for Court Action and Additional Provisions

Upon application by the corporation, specified entities, or any other person claiming to be substantially and adversely affected by a ratification, a court may (1) determine the validity of any ratification or (2) modify or waive any of the procedures required by the bill to ratify a defective corporate act. An action must be brought within 120 days of a ratification being approved by stockholders or notice of a ratification being given to stockholders and any holders of putative stock, as specified.

The bill specifies that ratifying a defective corporate act pursuant to the bill's requirements may not be construed to be the exclusive means of ratifying or validating a defective corporate act. The bill may not be construed to limit the ability of a corporation to file certificates or charter documents in accordance with any other statutory provision. Furthermore, the absence or failure of ratification in accordance with the bill's requirements must not, of itself, affect the validity or effectiveness of any corporate act otherwise lawfully ratified, nor may it create a presumption that any corporate act is or was a defective corporate act or void or voidable.

The bill specifically extends applicability of its provisions to real estate investment trusts.

Current Law: The Corporations and Associations Article does not specify procedures by which a corporation may generally ratify such defective corporate acts, although §§ 2-208(e) and 2-208.1(e) provide safe harbors if stock is issued before articles supplementary are filed, as specified.

State Expenditures: SDAT incurs one-time costs of \$278,400 for programming updates to be able to accept articles of validation as required and specified under the bill.

Additional Comments: The bill implements recommendations of the Maryland State Bar Association, whose Committee on Corporation Law regularly reviews the Corporations and Associations Article.

Additional Information

Prior Introductions: None.

Designated Cross File: SB 879 (Senator Waldstreicher) - Judicial Proceedings.

Information Source(s): State Department of Assessments and Taxation; Department of Legislative Services

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