



2022 REPORT OF THE COMMITTEE ON CORPORATION LAW
OF THE SECTION ON BUSINESS LAW OF THE MARYLAND STATE BAR ASSOCIATION
WITH RESPECT TO
HOUSE BILL 996 / SENATE BILL 879
“CORPORATIONS AND ASSOCIATIONS –
RATIFICATION OF DEFECTIVE CORPORATE ACTS”

I. INTRODUCTION

The Committee on Corporation Law of the Section on Business Law of the Maryland State Bar Association monitors the Maryland General Corporation Law, the Maryland REIT Law, and the application and utility of other Maryland business-related laws. Our committee, working with Senator Waldstreicher and Delegate Brooks, has developed and is pleased to support House Bill 996 and Senate Bill 879 **with certain Sponsor Amendments** (which, as of the date of this testimony, are in process).

II. BACKGROUND

During the course of legal due diligence, it is not unusual to discover that a corporation has issued more stock than it had legally authorized through its charter or has made other corporate missteps. Early-stage corporations, often without the resources to engage experienced financial or legal professionals, may be too preoccupied with growth plans or simple survival to focus on basic corporate housekeeping. This species of legal flaw, and others like it, are commonly known as “defective corporate acts,” and can exist undetected for years in corporations, coming to light at the worst possible time. Examples of defective corporate actions subject to ratification include:

- the failure of the board of directors to adopt bylaws;
- the failure of a board of directors to elect required officers of the corporation;
- corporate action taken in the absence of board resolutions authorizing the action;
- the failure to obtain the requisite stockholder approval of a corporate action;

- the failure to file with the State Department of Assessments and Taxation of the State of Maryland (the “SDAT”) a required charter document; and
- issuance of shares in the absence of evidence that consideration payable to the corporation for shares was received.

Presently, defective corporate acts may be remedied under common law, through a variety of approaches, but not with the certainty that third party acquirers, investors or lenders would prefer.

The Model Business Corporation Act, the Delaware General Corporation Law and laws in a dozen other states provide statutory safe harbors with clear mechanisms to permit a corporation to rectify defective corporate acts. Although the Maryland General Corporation Law contains a limited safe harbor pertaining to the over issuance of preferred stock (*see* Maryland General Corporation Law § 2-208(e) and 2-208.1(e)), Maryland corporations have otherwise had to rely upon common law ratification to remedy defective corporate acts. The Committee on Corporation Law of the Section on Business Law of the Maryland State Bar Association, proposes a new subtitle 7 of Title 2 of the Maryland General Corporation Law, developed in conjunction with Senators Waldstreicher and Delegate Brooks, drawing from the best precedents to balance the interests of Maryland corporations, stockholders and other interested parties.

III. NEW SECTION 2-702 SAFE HARBOR – RATIFICATION OF DEFECTIVE CORPORATE ACTS

Section 2-702 provides a statutory ratification procedure for corporate actions that may not have been properly authorized and stock that may have been improperly issued. The statutory ratification procedure under new Section 2-702 is designed to supplement common law ratification – not replace it – and provides a safe harbor and level of certainty that sometimes cannot be achieved with common law ratification.

The new ratification procedure and safe harbor is intended to be available only where there is objective evidence that a corporate action was defectively implemented. For example, Section 2-702 would permit ratification of stock previously issued but subsequently determined to have been issued improperly. It would not permit a corporation to issue stock retroactively as of an earlier date where there is no objective evidence that the stock had previously been issued.

Defective corporate acts ratified in accordance with Section 2-702 become effective on the date described in Section 2-703 and are not dependent on the expiration of the 120-day time period in which an action challenging the ratification may be brought under new Section 2-706(a). If a filing with the SDAT was required in connection with the defective corporate act, or if the filing was made but now must be corrected, new Section 2-705 requires that “Articles of Validation” be filed following ratification. This is intended to provide a clear public record of the actions relating to ratification. Nevertheless, in instances where the defective corporate act would not have required a filing with SDAT in the first instance, filing Articles of Validation is not required in order to accomplish ratification.

Defective corporate acts ratified in accordance with Section 2-702 are not void or voidable.

IV. DIRECTOR AND STOCKHOLDER ROLES IN RATIFICATION OF DEFECTIVE CORPORATE ACTS

Defective corporate acts sometimes involve failure of the board of directors to act or to properly record their action. In those instances, a defective corporate act can be remedied by the board of directors without stockholder involvement. Where a defective corporate act would have required stockholder action or approval, ratification of the defective corporate act still requires the same approval under new Section 2-704. By involving stockholders in ratification of a defective corporate act as appropriate and, as required by the existing Maryland General Corporation Law, the new statute balances the obligations of the board of directors to manage the affairs of the corporation with the rights of stockholders otherwise present throughout the Maryland General Corporation Law. Further, where stockholder approval is not required, notice to the stockholders of the board's ratification of the defective corporate act may be given under new Section 2-704(b). Only by giving such notice, however, may a corporation obtain the finality as to ratification that is offered by new Section 2-706 described below. This results in an improvement in transparency over common law ratification, which does not offer the same procedure.

V. DETERMINATION OF THE VALIDITY OF RATIFICATION

New Section 2-706 confers on a court with jurisdiction over the parties the ability to hear claims regarding the validity of any ratification of a defective corporate act under the new subtitle. New Section 2-706 provides standing to the corporation, any successor entity to the corporation, any director of the corporation, any record or beneficial holder of valid stock or putative stock, any record or beneficial holder of putative stock as of the date of the defective corporate act, any holder of a voting trust certificate, any holder of a voting trust certificate as of the date of the defective corporate act and any other person claiming to be substantially and adversely affected by a ratification of a defective corporate act to seek redress from a court of competent jurisdiction. The court may (1) determinate the validity of any ratification under the new subtitle; or (2) modify or waive any of the procedures required by the subtitle to ratify a defective corporate act.

In addition to granting certain powers beyond those contained with in Subtitle 4 of Title 3 of the Courts and Judicial Proceedings Article of the Maryland Code, Section 2-706 solves for two problems faced by parties seeking judicial intervention in relation to the ratification of defective corporate acts. First, it provides standing to obtain a judicial determination in the absence of a justiciable controversy under Section 3-409(a) of the Courts and Judicial Proceedings Article of the Maryland Code. Second, it provides the court with the ability to modify or waive any of the procedures required by Subtitle 7 of Title 2 of the Maryland General Corporation Law where the procedure is not achievable or advisable, if equity warrants ratification of the defective corporate act. This limited right to obtain judicial intervention is circumscribed by the 120-day limitation described in New Section 2-706(b) to provide the corporation and interested parties with finality under the safe harbor.

VI. PROPOSED SPONSOR AMENDMENTS

As of the date of this testimony, several Sponsor Amendments have been requested to better align the bill with the Model Business Corporation Act and the draft legislation that was proposed by the Committee on Corporation Law of the Section on Business Law of the Maryland State Bar Association.

VII. CONCLUSION

The Committee on Corporation Law of the Section on Business Law of the Maryland State Bar Association urges the House Economic Matters Committee to issue a favorable recommendation in support of the bill **with the proposed Sponsor Amendments**.

Respectfully submitted,

MSBA Section of Business Law, Committee on
Corporation Law

William E. Carlson, Chair

Scott R. Wilson, Vice Chair

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