



**2022 REPORT OF THE COMMITTEE ON CORPORATION LAW
OF THE SECTION ON BUSINESS LAW OF THE MARYLAND STATE BAR ASSOCIATION
WITH RESPECT TO**

SENATE BILL 879 / HOUSE BILL 996

**“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 Senate Bill 879 and House Bill 996 (“Corporations and Associations – Ratification of Defective Corporate Acts”) and the Sponsor Amendment submitted by them.

**Our Committee is
FAVORABLE in support of SB 879 and the Sponsor Amendment.**

II. OVERVIEW

Senate Bill 879 would add a new Subtitle 7 to Title 2 of the Maryland General Corporation Law providing a statutory safe harbor procedure for ratifying corporate acts or transactions and stock that, due to a “failure of authorization”, would be void or voidable. The safe harbor procedure enables a board of directors to adopt a ratifying resolution. If the act being ratified would have required stockholder approval at the time of the defective act or at the time of the later ratification, stockholder approval will also be required.

The term “defective corporate act” is intended to include all corporate acts and transactions, including the election of directors, purportedly taken, that were within the power granted to a corporation under the MGCL, but are subsequently determined not to have been effected in accordance with the applicable provisions of the MGCL, the corporation’s charter or bylaws, or agreements, where the failure to comply with such provisions would render such act void or voidable. The term “defective corporate act” includes an “overissue” of stock and other defects in stock issuances that could cause stock to be void or voidable.

Early-stage or underfunded corporations, 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. Alternatively, their lawyers may not be experienced or may make mistakes. Unfortunate “defective corporate acts” can exist undetected for years in corporations, coming to light at the worst possible time, just before a sale or merger, a major investment, or a bank loan.

Examples of defective corporate actions include:

- the failure of the board of directors to adopt bylaws and to elect required corporate officers (which prevents a corporation from being “duly organized”)
- 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
- issuance of shares in the absence of evidence that consideration payable to the corporation for shares was received
- an overissuance of shares of stock
- the issuance of “putative stock”

Overissued shares are those shares issued in excess of the number of shares authorized by the board of directors. Putative stock is shares of stock that but for a failure of authorization would have been validly issued and any other shares that the board of directors cannot determine to be valid stock. When a single issuance includes both valid stock and putative stock, or where trading in valid stock and putative stock precludes the tracing of specific shares as valid stock or putative stock (and it cannot be determined from the records of the corporation which shares so issued are valid shares and which are putative stock), all the shares issued in such issuance would be deemed to be putative stock.

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 nonstatutory approaches include the general doctrine of ratification, stockholder ratification (i.e., a fully informed vote of the stockholders to approve an act by the board of directors that does not require stockholder approval), rescission offerings, and waivers, consents, and agreements by or with impacted parties. Under Section 2-707 of new Subtitle 7, the new statutory safe harbor approach would not be the exclusive means by which a corporation could ratify a defective corporate act.

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 provides for

Certificates of Correction (see MGCL § 1-207), which have limited utility, and contains a limited safe harbor pertaining to the overissuance of preferred stock (see MGCL § 2-208(e) and 2-208.1(e)), Maryland corporations have otherwise had to rely upon common law ratification to remedy defective corporate acts.

III. PROCESS UNDER SECTIONS 2-702 THROUGH 2-705

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 board of directors had attempted to issue stock.

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 charter 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 charter 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 stockholder approval in accordance with new Section 2-704. By involving stockholders in certain ratifications of defective corporate acts 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, but is not required to 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 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 within Subtitle 4 of Title 3 of the Courts and Judicial Proceedings Article of the Maryland Code, new Section 2-706 solves 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. If a defective corporate act or putative stock is ratified in accordance with new Sections 2-702 through 2-705, then no person to whom notice of the ratification was given may assert any claim that the defective corporate act or putative stock is void or voidable due to the failure of authorization identified in the ratifying resolution, or that the court should determine that the ratification should not be effective or should be effective only on certain conditions, unless that claim is brought within 120 days from the date on which ratification occurred (if approved by the stockholders) or, if no stockholder approval was required, 120 days from the date on which a notice was given to the stockholders (provided that such notice was given within 60 days after such ratification).

VI. SPONSOR AMENDMENT

A Sponsor Amendment has been filed to better align SB 879 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. (The same Sponsor Amendment was filed with HB 996.) We support the Sponsor Amendment.

VII. CONCLUSION

The Committee on Corporation Law of the Section on Business Law of the Maryland State Bar Association urges the Judicial Proceedings Committee to issue a favorable recommendation in support of Senate Bill 879 and the Sponsor Amendment sponsored by Senator Waldstreicher.

Respectfully submitted,

MSBA Section of Business Law, Committee on
Corporation Law

William E. Carlson, Chair
Scott R. Wilson, Vice Chair

March 8, 2022