

Delaware Corporation Law Statute Amended to Provide for Ratification and Validation of Defective Corporate Acts

Written by Paul Bork, Erica Rice

July 18, 2013

As part of recent amendments to the Delaware General Corporations Law (DGCL), two new sections were added to the DGCL to facilitate the ratification of so-called “defective corporate acts” that would otherwise be invalid due to improper corporate authorization. New Sections 204 and 205 of the DGCL (the Ratification Provisions), which go into effect on April 1, 2014, provide Delaware corporations the opportunity to undertake a more thorough “corporate clean-up” than is currently permitted under the DGCL.

Why Are Ratification Provisions Necessary?

The Ratification Provisions will allow a corporation to take measures to remove uncertainty surrounding its capital structure, which is particularly important when a corporation is the target of an acquisition or is in the process of conducting an initial public offering. During the course of an acquisition or IPO, a corporation – or more likely, its counsel – will typically conduct a thorough review of the corporate books and records and engage in a process to “clean up” any incorrect or incomplete records. The clean-up process often includes the adoption of resolutions by the corporation’s board of directors and stockholders ratifying certain past acts of the corporation.

However, under the DGCL, certain invalid corporate actions cannot be remedied through subsequent ratification. In particular, if a corporation issued shares of capital stock in excess of the number of shares of authorized stock at the time of such issuance (the Ratification Provisions call these over-issued shares “putative stock”), the issuance is *void* and cannot be ratified. Over-issues of stock can have far-reaching effects. For example, if the Company’s board of directors is elected by persons holding putative stock rather than valid stock, the board’s election is also invalid. The Ratification Provisions are primarily intended to address these situations, although they are also available to ratify any other type of corporate act that is void or voidable due to a failure of proper corporate authorization.

The Ratification Provisions establish a process for ratification of defective corporate acts or putative stock by a corporation itself (under Section 204), as well as validation of defective corporate acts or putative stock by the Delaware Chancery Court (under Section 205). Upon ratification or validation by either the corporation or the Court, the defective corporate act will be deemed retroactively effective and valid as of the time of the defective corporate act.

What Is the Process Under Section 204?

In order to ratify defective corporate acts or putative stock under Section 204:

- The board of directors must adopt a resolution ratifying the defective corporate act or putative stock, and containing certain other information about the defective corporate act.
- If the defective corporate act (such as an amendment to the corporation’s charter) would have required stockholder approval, the stockholders must also adopt the ratification resolution. The corporation must provide stockholders with 20 days’ notice of the meeting at which the resolution is to be adopted. This notice must go to holders of valid stock and putative stock, whether voting or nonvoting, both current and at the time of the defective corporate act. The notice must include a statement that any challenge to the ratification of the defective corporate act must be brought within 120 days of the effective time of the ratification.
- Once approved by the board and, if applicable, the stockholders, the corporation must file a “certificate of validation” with the Delaware secretary of state. This certificate is currently being developed by the secretary of state’s office – which is one reason for

the delay in effectiveness of the Ratification Provisions to April of 2014.

- If stockholder approval was not required, the corporation must provide notice of the ratification to stockholders within 60 days' of adoption of the ratification resolution by the board. This notice must go to holders of valid stock and putative stock, whether voting or nonvoting, both current and at the time of the defective corporate act. The notice must include a statement that any challenge to the ratification of the defective corporate act must be brought within 120 days of the effective time of the ratification.

Validation of Defective Corporate Acts by the Delaware Chancery Court Under Section 205

If a corporation is unable (due to the lack of a properly authorized board, for example) or unwilling to undertake the process contained in Section 204, certain parties may directly petition the Delaware Chancery Court to validate independently any defective corporate act or putative stock. Section 205 also give the Court jurisdiction to hear challenges to the validity and effectiveness of any ratification undertaken by a corporation pursuant to Section 204.

The parties that can bring a claim under Section 205 include the corporation, any successor entity, any member of the board, any record or beneficial holder of valid stock or putative stock, any record or beneficial holder of valid or putative stock as of the time of a defective corporate act, or any other person claiming to be substantially and adversely affected by a ratification pursuant to Section 204. However, the timeline for a Section 204 challenge is fairly short, giving the corporation a measure of certainty. With some exceptions, any action requesting review of a Section 204 ratification must be brought within 120 days of the effective time of the certificate of validation.

RELATED PRACTICES

- [Capital Markets](#)
- [Business Counseling](#)

This communication is intended for general information purposes and as a service to clients and friends of Foley Hoag LLP. This communication should not be construed as legal advice or a legal opinion on any specific facts or circumstances, and does not create an attorney-client relationship.

United States Treasury Regulations require us to disclose the following: Any tax advice included in this document was not intended or written to be used, and it cannot be used, for the purpose of avoiding penalties under the Internal Revenue Code.

Attorney advertising. Prior results do not guarantee a similar outcome. © 2017 Foley Hoag LLP. All rights reserved.