

OREGON STATE BAR
Legislative Proposal
Part I – Legislative Summary

RE: Providing for the Ratification of Defective Corporate Action

Submitted by: Oregon State Bar Business Law Section

Legislative Contact(s): Susan Grabe

Phone: (503) 431-6380

E-mail: sgrabe@osbar.org

This bill would add the following new Subchapter to ORS Chapter 60:

Section 1 – Definitions

Section 2 – Defective corporate actions

Section 3 – Ratification of defective corporate actions

Section 4 – Action or ratification

Section 5 – Notice requirements

Section 6 – Effect of ratification

Section 7 – Filings

Section 8 – Judicial proceedings regarding validity of corporate actions

This bill would amend the following ORS sections:

ORS 60.011 – Effective date and time of document

ORS 60.084 – Validity of corporate acts

ORS 60.207 – Court-ordered meeting

1. PROBLEM PRESENTED (including level of severity):

Oregon has no statutory procedure for correcting defective corporate action. When an Oregon corporation's directors or shareholders take corporate action without proper authorization, or without strictly adhering to corporate formalities, that action is likely, or at least could be, invalid. For example, the issuance of stock in excess of the number of shares authorized in the corporation's articles of incorporation, the subsequent election of directors by the shareholders, and corporate action later approved by the defective board may all be invalid corporate actions. Upon realizing the potential invalidity of past corporate acts, a company's directors or shareholders may wish to fix the problem by ratifying the defective acts. However, Oregon law is unclear about what defective acts can be ratified after the fact.

While there is little legal precedent in Oregon law on this issue, case law in some jurisdictions has developed a distinction between corporate acts that are "void" and incapable of ratification and cure, and acts that are merely "voidable" and may be ratified and cured. According to the U.S. Court of Appeals for the D.C. Circuit, "[T]he essential distinction between voidable and void acts are that those acts which the corporation could accomplish lawfully but which it has undertaken to accomplish in an inappropriate manner are voidable. Acts which the corporation could not accomplish lawfully, no matter how undertaken, are void and cannot be cured." *CarrAmerica Realty Corp. v. Kaidanow*, 321 F.3d 165, 170 (D.C. Cir. 2003). The distinction is not a clear one, however, and there remains no definite line between which defective corporate acts may be cured and which may not. *See, e.g., Staar Surgical Co. v. Waggoner*, 588 A.2d

1130, 1136 (Del. 1991); Bigler & Tillman, *Void or Voidable?—Curing Defects in Stock Issuances Under Delaware Law*, BUSINESS LAWYER, August 2008.

This lack of clarity led the Delaware legislature to recently amend the Delaware General Corporation Law to allow for ratification of defective corporate acts. Under the amendment, which took effect April 1, 2014, invalid corporate actions can be ratified through board and shareholder resolutions if specific criteria are met. Providing a statutory procedure to ratify defective corporate acts gives certainty and clarity to an otherwise opaque area of law. Delaware's new law protects shareholders by requiring a strict ratification procedure and at the same time eliminates the unclear distinction between void and voidable corporate acts: all corporate acts may be ratified and cured. The Delaware law also provides a procedure for contesting ratification where appropriate.

Following the adoption of the Delaware law, the Corporate Laws Committee of the American Bar Association Business Law Section has proposed a new subchapter to the Model Business Corporation Act that also permits ratification of defective corporation actions. Oregon's Business Corporation Act is already modeled after the Model Business Corporation Act.

Oregon has no substantive case law distinguishing between void and voidable corporate acts and no statute that provides a procedure for curing defective corporate actions. This uncertainty may hamper an Oregon business's ability to raise capital or conduct its business because a prior defective action may taint future corporate actions.

2. SOLUTION:

Add new sections to the Oregon Business Corporation Act, modeled after the Model Business Corporation Act, to provide a procedure for ratification of defective shareholder or director corporate action and a process for affected parties to contest the ratification.

Substantially similar changes are proposed for the Oregon Nonprofit Corporation Act.

3. PUBLIC POLICY IMPLICATION of this proposed legislative change:

There would be no significant shift in public policy. In fact, the suggested statutory additions would be in line with the broader trend of requiring compliance with corporate formalities without imposing an overly rigid system that contravenes the good faith intent of the shareholders and directors of a corporation.

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Part II – Legislative Language

O.R.S. § 60.011 Effective date and time of document [Inserted language in bold, deleted language with strikethrough]

(1) Except as provided in subsection (2) of this section, and ORS 60.014(3), **[New Subchapter, Section 2(3) and Section 6]**, a document accepted for filing is effective on the date it is filed by the Secretary of State and at the time, if any, specified in the document as its effective time or at 12:01 a.m. on that date if no effective time is specified.

(2) If a document specifies a delayed effective time and date, the document becomes effective at the time and date specified. If a document specifies a delayed effective date but no time, the document becomes effective at 12:01 a.m. on that date. A delayed effective date for a document may not be later than the 90th day after the date it is filed.

O.R.S. § 60.084 Validity of corporate acts [Inserted language in bold]

(1) Except as provided in subsection (2) of this section **[or New Subchapter, Section 2]**, the validity of corporate action may not be challenged on the ground that the corporation lacks or lacked power to act.

(2) A corporation's power to act may be challenged:

(a) In a proceeding by a shareholder against the corporation to enjoin the act;

(b) In a proceeding by the corporation, directly, derivatively, or through a receiver, trustee or other legal representative against an incumbent or former director, officer, employee or agent of the corporation; ~~or~~

(c) In a proceeding by the Attorney General under ORS 60.661; **or**

(d) In a proceeding under [New Subchapter, Section 8].

(3) In a shareholder's proceeding under subsection (2)(a) of this section to enjoin an unauthorized corporate act, the court may enjoin or set aside the act, if equitable and if all affected persons are parties to the proceeding, and may award damages for loss other than anticipated profits suffered by the corporation or another party because of enjoining the unauthorized act.

O.R.S. § 60.207 Court-ordered meeting [Inserted language in bold, deleted language with strikethrough]

(1) The circuit court of the county where a corporation's principal office is located, or, if the principal office is not in this state, where the registered office of the corporation is or was last located, may summarily order a meeting to be held:

(a) On application of any shareholder of the corporation entitled to participate in an annual meeting if an annual meeting was not held within the earlier of six months after the end of the corporation's fiscal year or 15 months after its last annual meeting; or

(b) On application of a shareholder who signed a demand for a special meeting valid under ORS 60.204 and notice of the special meeting was not given within 30 days after the date the demand was delivered to the corporation's secretary or the special meeting was not held in accordance with the notice; or

(c) In accordance with [New Subchapter, Section 8].

(2) The court may fix the time and place of the meeting, determine the shares entitled to participate in the meeting, specify a record date for determining shareholders entitled to notice of and to vote at the meeting, prescribe the form and content of the meeting notice, fix the quorum required for specific matters to be considered at the meeting or direct that the votes represented at the meeting constitute a quorum for action on those matters and enter other orders necessary to accomplish the purpose or purposes of the meeting.

(3) The shareholders' request shall be set for hearing at the earliest possible time and shall take precedence over all matters, except matters of the same character and hearings on preliminary injunctions under ORCP 79 B(3). No order shall be issued by the court under this section without notice to the corporation at least five days in advance of the time specified for the hearing unless a different period is fixed by order of the court.

Section 1 Definitions. [New ORS section added] As used in this subchapter:

(1) "Claim" means a claim made in an application under Section 8.

(2) "Corporate action" means any action taken by or on behalf of the corporation, including any action taken by the incorporator, the board of directors, a committee, an officer or agent of the corporation or the shareholders.

(3) "Corrected corporate action" means any defective corporate action that is ratified or validated in accordance with this subchapter.

(4) "Date of the defective corporate action" means the date the defective corporate action was purported to have been taken, or if the exact date is unknown, the approximate date thereof.

(5) "Defective corporate action" means (a) any corporate action purportedly taken that is, and at the time the corporate action was purportedly taken would have been, within the power of the corporation, but is void or voidable due to a failure of authorization, or (b) an overissue.

(6) "Failure of authorization" means the failure to authorize, approve or otherwise effect a corporate action in compliance with this chapter, the articles of incorporation or bylaws of the corporation, a corporate resolution or any plan or agreement to which the corporation is a party, if and to the extent the failure would render the corporate action void or voidable.

(7) "Overissue" means the purported issuance of shares of a class or series of the corporation:

(a) in excess of the number of shares of a class or series the corporation has the power to issue under ORS 60.131 at the time of the issuance; or

(b) that is not then authorized for issuance by the articles of incorporation.

(8) "Putative shares" means the shares of any class or series of the corporation (including shares issued upon exercise of rights, options, warrants or other securities convertible into shares of the corporation, or interests with respect thereto) that were created or issued as a result of a defective corporate action, that:

(a) but for the defective corporate action, would constitute valid shares; or

(b) cannot be determined by the board of directors to be valid shares.

(9) "Subchapter" means Section 1 through Section 8.

(10) "Valid shares" means the shares of any class or series of the corporation that have been duly authorized and validly issued in accordance with this chapter, including as a result of ratification or validation under this subchapter.

(11) "Validation effective time" with respect to any corrected corporate action means the later of the time at which:

(a) the ratification of the defective corporate action is approved by the shareholders, or if shareholder approval is not required, the time at which the notice required by Section 5 becomes effective in accordance with ORS 60.034; and

(b) any articles of validation filed in accordance with Section 7 become effective.

The validation effective time shall not be affected by the filing or pendency of a judicial proceeding under Section 8 or otherwise, unless otherwise ordered by the court.

Section 2 Defective corporate actions. [New ORS section added]

(1) A defective corporate action shall not be void or voidable if ratified in accordance with Section 3 or validated in accordance with Section 8.

(2) Ratification under Section 3 or validation under Section 8 is not the exclusive means of ratifying or validating a defective corporate action. The absence or failure of ratification or validation in accordance with this subchapter shall not, of itself (a) affect the validity or effectiveness of any corporate action properly ratified under common law or otherwise, or (b) create a presumption that the corporate action is or was a defective corporate action or void or voidable.

(3) In the case of an overissue, putative shares shall be valid shares effective as of the date originally issued or purportedly issued upon the effectiveness of, as applicable:

(a) an amendment to the articles of incorporation under this subchapter and under ORS 60.431 through 60.457 authorizing, designating or creating the shares; or

(b) any other corporate action under this subchapter ratifying or validating the authorization, designation or creation of the shares.

Section 3 Ratification of defective corporate actions. [New ORS section added]

(1) To ratify a defective corporate action under this section (other than ratifying the election of the initial board of directors under subsection (2)), the board of directors shall take action ratifying the defective corporate action in accordance with Section 4, stating:

- (a) the defective corporate action to be ratified and, if the defective corporate action involved the issuance of putative shares, the number and type of putative shares purportedly issued;
- (b) the date of the defective corporate action;
- (c) the nature of the failure of authorization or overissue with respect to the defective corporate action to be ratified; and
- (d) that the board of directors ratifies the defective corporate action.

(2) To ratify a defective corporate action that relates to the election of the initial board of directors of the corporation under ORS 60.057(2), a majority of the persons who, at the time of the ratification, are exercising the powers of directors may take an action stating:

- (a) the name of the person or persons who first took action in the name of the corporation as the initial board of directors;
- (b) the earlier of the date on which such persons first took such action or were purported to have been elected as the initial board of directors; and
- (c) that the ratification of the election of such person or persons as the initial board of directors is approved.

(3) The board of directors' ratification of a defective corporate action under subsection (1) shall be submitted to the shareholders for approval in accordance with Section 4 if any provision of this chapter, the articles of incorporation or bylaws, any corporate resolution or any plan or agreement to which the corporation is a party in effect at the time action under subsection (1) is taken requires shareholder approval, or would have required shareholder approval at the date of the defective corporate action.

(4) Unless otherwise provided in the action taken by the board of directors under subsection (1), after the action by the board of directors has been taken and, if required, approved by the shareholders, the board of directors may abandon the ratification at any time before the validation effective time without further action of the shareholders.

Section 4 Action or ratification. [New ORS section added]

(1) The quorum and voting requirements applicable to a ratifying action by the board of directors under Section 3(1) shall be the board of directors' quorum and voting requirements applicable to the defective corporate action proposed to be ratified at the time the ratifying action is taken.

(2) If the ratification of the defective corporate action requires approval by the shareholders under Section 3(3), and if the approval is to be given at a meeting, the corporation must notify each holder of valid and putative shares, whether or not entitled to vote, as of the record date for notice of the meeting and as of the date of the occurrence of defective corporate action, provided that notice shall not be required to be given to holders of valid or putative shares whose identities or addresses for notice cannot be determined from the records of the corporation. The notice required by this subsection must:

- (a) state that the purpose, or one of the purposes, of the meeting is to consider ratification of a defective corporate action;

(b) be accompanied by (A) a copy of the action taken by the board of directors in accordance with Section 3(1) or (B) the information required by ORS Section 3(1)(a) through Section 3(1)(d); and

(c) conspicuously state that any claim must be brought within 120 days after the later of the applicable validation effective time or the time at which the notice required by this section is given. The statement required by this subsection (c) must include the calendar date by which a claim must be filed in accordance with Section 8 if the date can be calculated at the time the notice is given, or if it cannot be then calculated, (A) the calendar date by which the corporation anticipates that a claim must be filed in accordance with Section 8 and (B) a statement that the notice recipient may contact the corporation to determine the exact date by which a claim must be filed.

(3) Except as provided in subsection (4) with respect to the voting requirements to ratify the election of a director, the shareholder quorum and voting requirements to approve a defective corporate action ratified in accordance with Section 3 and submitted to the shareholders for approval shall be the shareholder quorum and voting requirements applicable to the defective corporate action at the time the ratifying action is taken.

(4) The approval by shareholders to ratify the election of a director requires that the votes cast within the voting group favoring the ratification exceed the votes cast opposing the ratification of the election at a meeting at which a quorum is present.

(5) Putative shares on the record date for determining the shareholders entitled to vote on any matter submitted to shareholders under Section 3(3) (and without giving effect to any ratification of putative shares that becomes effective as a result of the vote) shall neither be entitled to vote nor counted for quorum purposes in any vote to approve the ratification of any defective corporate action. However, if the corporation has no valid shares outstanding, and only putative shares are outstanding, then all putative shares shall be entitled to vote and counted for quorum purposes in any vote to approve the ratification of any defective corporate action.

(6) If the approval under this section of putative shares would result in an overissue, in addition to the approval required by Section 3, approval of an amendment to the articles of incorporation of the corporation under ORS 60.431 through 60.457 to increase the number of shares of an authorized class or series or to authorize the creation of a class or series of shares so there would be no overissue shall also be required.

Section 5 Notice requirements. [New ORS section added]

(1) Unless shareholder approval is required under Section 3(3), prompt notice of an action taken under Section 3 shall be given to each holder of valid and putative shares, whether or not entitled to vote, as of the date of the (a) action taken under Section 3(1) or Section 3(2) and (b) defective corporate action, provided that notice shall not be required to be given to holders of valid and putative shares whose identities or addresses for notice cannot be determined from the records of the corporation.

(2) The notice required by subsection (1) must:

(a) contain a copy of the action taken in accordance with Section 3(1) or Section 3(2) or the information required by ORS Section 3(1)(a) through Section 3(1)(d) or Section 3(2)(a) through Section 3(2)(c), as applicable; and

(b) conspicuously state that any claim must be brought within 120 days after the later of the applicable validation effective time or the time at which the notice required by this section is

given. The statement required by this subsection (b) must include the calendar date by which a claim must be filed in accordance with Section 8 if the date can be calculated at the time the notice is given, or if it cannot be then calculated, (A) the calendar date by which the corporation anticipates that a claim must be filed in accordance with Section 8 and (B) a statement that the notice recipient may contact the corporation to determine the exact date by which a claim must be filed.

(3) No notice under this section is required with respect to any action required to be submitted to shareholders for approval under Section 3(3) if notice is given in accordance with Section 4(3).

(4) A notice required by this section may be given in any manner permitted by ORS 60.034 and, for any corporation subject to the reporting requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, may be given by means of a filing or furnishing of the notice with the United States Securities and Exchange Commission.

Section 6 Effect of ratification. [New ORS section added] From and after the validation effective time, and without regard to the 120-day period during which a claim may be brought under Section 8:

(1) Each corrected corporate action shall (a) not be void or voidable as a result of the defective corporate action identified in the action taken under Section 3 and (b) be deemed a valid corporate action effective as of the date of the defective corporate action;

(2) The issuance of each putative share or fraction of a putative share purportedly issued pursuant to a corrected corporate action and identified in the action taken under Section 3 shall not be void or voidable, and each putative share or fraction of a putative share shall be deemed to be an identical share or fraction of a valid share as of the time it was purportedly issued;

(3) Any corporate action taken after the date of the defective corporate action in reliance on the defective corporate action having been validly effected and any subsequent defective corporate action resulting directly or indirectly from the original defective corporate action, shall be valid as of the time taken and

(4) **[INSERT LITIGATION COMMITTEE'S LANGUAGE CLARIFYING THE EFFECT OF RATIFICATION.]**

Section 7 Filings. [New ORS section added]

(1) If a defective corporate action ratified or validated under this subchapter requires, or would have required at the date of the defective corporate action, a filing under and in accordance with this chapter, then, whether or not a filing was previously made in respect of the defective corporate action and in lieu of a filing otherwise required by this chapter, the corporation shall file articles of validation in accordance with this section, and the articles of validation shall serve to amend or substitute for any other filing with respect to the defective corporate action required by this chapter.

(2) The articles of validation shall set forth:

(a) the defective corporate action that is the subject of the articles of validation (including, in the case of any defective corporate action involving the issuance of putative shares, the number and type of putative shares issued and the date or dates upon which the putative shares were purported to have been issued);

(b) the date of the defective corporate action;

(c) the nature of the failure of authorization or overissue in respect of the defective corporate action;

(d) a statement that the defective corporate action was ratified in accordance with Section 3, including the date on which the defective corporate action was ratified under Section 3(1) or Section 3(2) and the date, if any, on which the shareholders approved the ratification of the defective corporate action; and

(e) the information required by subsection (3).

(3) The articles of validation shall also contain the following information:

(a) if a filing was previously made in respect of the defective corporate action and no changes to the filing are required to give effect to the ratification of the defective corporate action in accordance with Section 3, the articles of validation shall set forth (A) the name, title and filing date of the filing previously made and any articles of correction thereto and (B) a statement that a copy of the filing previously made, together with any articles of correction thereto, is attached as an exhibit to the articles of validation;

(b) if a filing was previously made in respect of the defective corporate action and the filing requires any change to give effect to the ratification of the defective corporate action in accordance with Section 3, the articles of validation shall set forth (A) the name, title and filing date of the filing previously made and any articles of correction thereto, (B) a statement that a filing containing all of the information required to be included under the applicable section or sections of this chapter to give effect to the defective corporate action is attached as an exhibit to the articles of validation, and (C) the date and time that the filing is deemed to have become effective; or

(c) if a filing was not previously made in respect of the defective corporate action and the corrected corporate action would have required a filing under any other section of this chapter, the articles of validation shall set forth (A) a statement that a filing containing all of the information required to be included under the applicable section or sections of this chapter to give effect to the defective corporate action is attached as an exhibit to the articles of validation, and (B) the date and time that the filing is deemed to have become effective.

Section 8 Judicial proceedings regarding validity of corporate actions. [New ORS section added]

(1) Upon application by the corporation, any successor entity to the corporation, a director of the corporation, any shareholder, beneficial shareholder or unrestricted voting trust beneficial owner of the corporation, including any shareholder, beneficial shareholder or unrestricted voting trust beneficial owner as of the date of the defective corporate action ratified under Section 3, or any other person claiming to be substantially and adversely affected by a ratification under Section 3, the circuit court may:

(a) determine the validity and effectiveness of any corporate action or defective corporate action;

(b) determine the validity and effectiveness of any ratification under Section 3 and approval by shareholders under Section 4, if applicable;

(c) determine the validity of any putative shares; and

(d) modify or waive any of the procedures specified in Section 3 or Section 4 to ratify a defective corporate action.

(2) In connection with an action under this section, the court may make any findings or orders, and take into account any factors or considerations, regarding matters it deems proper under the circumstances.

(3) Service of process of the application under subsection (1) on the corporation may be made in any manner provided by statute of this state or by rule of the applicable court for service on the corporation, and no other party need be joined in order for the court to adjudicate the matter. In an action filed by the corporation, the court may require notice of the action be provided to other persons specified by the court and permit any other persons to intervene in the action.

(4) Notwithstanding any other provision of this section or otherwise under applicable law, any action asserting that the ratification of any defective corporate action and any putative shares issued as a result of the defective corporate action should not be effective, or should be effective only on certain conditions, must be brought within 120 days after the later of the applicable validation effective time or the time at which the notice required by Section 4 or Section 5, as applicable, is given. A person's failure to contact or delay in contacting the corporation to determine the calendar date by which a claim must be filed in accordance with this section will not eliminate or extend the 120-day period.

Substantially similar changes are proposed to the Oregon Nonprofit Corporation Act.