

Date of Hearing: June 12, 2023

ASSEMBLY COMMITTEE ON BANKING AND FINANCE

Timothy Grayson, Chair

SB 446 (Wilk) – As Introduced February 13, 2023

SENATE VOTE: 37-0

SUBJECT: Nonprofit and cooperative corporations: ratification or validation of noncompliant corporate actions

SUMMARY: Creates two mechanisms for a California nonprofit corporation or cooperative corporation to ratify or validate an otherwise-lawful corporate act that was not in compliance with relevant state corporation laws or the corporation’s articles or bylaws when it was made.

Specifically, **this bill:**

- 1) Allows for otherwise lawful corporate actions by a nonprofit or cooperative corporation not in compliance, or purportedly not in compliance, with state corporations laws, or a plan or agreement to which the corporation is a party in effect at the time of the corporate action, to be ratified or validated by the superior court.
- 2) Requires ratification of a corporate action to be approved by a corporation’s board of directors and, if applicable, by members in accordance with state corporations laws or the articles or bylaws in effect at the time of the ratification. If a higher approval standard was needed for the original corporate action, then the ratification must be approved in accordance with the higher approval standard.
- 3) Provides that the corporation or other authorized person may petition the superior court of the proper county, as defined, sitting in equity, to determine whether a particular corporate action was valid, to declare the efficacy of a corporate action, and to declare the date as of which the corporate action shall be deemed to have become effective or valid.
- 4) Requires a nonprofit or cooperation corporation to provide timely notice to courts or other dispute forums of any potential ratification or validation that would result in the dismissal of pending litigation.

EXISTING LAW:

- 1) Establishes the Nonprofit Corporation Law, which authorizes the formation of a corporation for range of purposes, including public, charitable, and religious purposes, on a not-for-profit basis. (Corp. Code Sec. 5002 et seq.)
- 2) Establishes the Cooperative Corporation Law, which authorizes the formation of a corporation for any lawful purpose provided that it is organized and conducts its business primarily for the mutual benefit of its members as “patrons” of the corporation. (Corp. Code Sec. 12200 et seq.)
- 3) Provides, for for-profit corporations formed under the General Corporations Law, two mechanisms for retroactively ratifying otherwise-lawful corporate actions, as follows:

- a) Ratification by resolution approved by a vote of the board and, if the corporate action requires shareholder approval, a vote of the shareholders or outstanding shares, as specified
- b) Ratification by a superior court in an action filed through a petition to determine the validity of a corporate action, as specified. (Corp. Code Sec. 119.)

FISCAL EFFECT: Unknown. This bill is keyed Fiscal by Legislative Counsel.

COMMENTS:

1) Purpose.

According to the author:

This bill would, for California nonprofit and cooperative corporations, authorize otherwise lawful corporate actions, as defined, not in compliance, or purportedly not in compliance, with the Corporations Code or the articles, bylaws, or a plan or agreement to which the corporation is a party in effect at the time of a corporate action, to be ratified, or validated by the superior court, in conformity with certain procedures.

2) Background

SB 218 (Jones), Chapter 217, Statutes of 2022, created new processes for a for-profit corporation to correct a prior corporate action that violated certain state corporation laws or the company's bylaws. Such improper corporate actions are typically inadvertent and usually the product of a small business or early-stage company's limited legal resources. For example, if a corporation issues shares of its stocks to investors but does not do this in full compliance with that corporation's bylaws, then that stock issuance, along with the votes of those stockholders, could be deemed invalid. Prior to SB 218, there was not a clear process to resolve this issue.

SB 218 established two discrete processes by which a corporation could ratify or validate a prior corporate action:

- a) Corporate ratification. Under the ratification process, the board of directors adopts a resolution and votes to ratify the action. If that action initially required shareholder approval, then the shareholders who would have originally voted on the action under the bylaws at the time must also vote to approve the ratification. The idea behind this process is to ensure the ratification process occurs in as similar a way as possible to the original vote. Moreover, if that corporate action was subject to a higher approval standard, such as a supermajority vote, then the ratification must also meet that standard.

One exception to this process is the appointment of the initial directors of the company. An improperly appointed board of directors can become an existential problem for a company because every subsequent decision made by that board can be deemed invalid. As a result of SB 218's reforms, the current board of directors can approve the

ratification by adopting a resolution setting forth the names of the intended initial directors and their appointment dates, and stating that the ratification of the initial directors is approved.

- b) Court validation. This bill's superior court validation procedure is an alternative to the corporate ratification procedure (or a follow-up to it in case of a failure to ratify) and allows the corporation, any director, or any shareholder or putative shareholder to petition the superior court for an order determining the validity of any corporate action. The court with jurisdiction in equity may decide to validate the action or decline to do so.

SB 218 also contained several limitations and guardrails. For example, a corporation cannot use either of these two processes to correct violations of specified Corporations Code sections, such as the requirement that a director perform duties in good faith.

3) What about nonprofits?

Unfortunately, the Legislature's work related to corporations and their governance is often too focused on for-profit corporations. This has come up in recent years, and often the Legislature has to pass additional legislation to create parity across corporation types. For example, a multi-year effort to allow for remote shareholder meetings focused primarily on for-profit companies, requiring additional legislation (AB 231 (Chen), of the 2023-24 Legislative Session) to give nonprofit corporations the same remote participation authorities as for-profit companies. In the future, it will save time and energy to include nonprofit corporations in any corporate governance policy discussion.

4) What does this bill do?

SB 446 extends the ratification measures currently available to for-profit corporations, described above, to nonprofit and cooperative corporations. The measures are nearly identical except for terminology changes (such as the use of "member") to reflect the differences in corporate structures. Supporters of the bill provide the following example of a case that would be covered by SB 446:

By way of example, a recent situation encountered by a California nonprofit corporation, a for-profit corporation took appropriate steps to convert to a nonprofit public benefit corporation, but the corporation failed to file its amended articles with the Secretary of State. That failure went unnoticed until recently, when the corporate existence of the nonprofit was apparently put into question.

REGISTERED SUPPORT / OPPOSITION:

Support

California Lawyers Association, Business Law Section
California Society of Enrolled Agents

Opposition

None

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