

**SENATE JUDICIARY COMMITTEE**  
**Senator Thomas Umberg, Chair**  
**2023-2024 Regular Session**

SB 446 (Wilk)  
Version: February 13, 2023  
Hearing Date: April 11, 2023  
Fiscal: Yes  
Urgency: No  
AWM

**SUBJECT**

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

**DIGEST**

This bill provides two mechanisms by which a California nonprofit corporation or cooperative corporation may ratify or validate an otherwise-lawful corporate act that was not in compliance with relevant state corporations laws or the corporation’s articles or bylaws when it was made.

**EXECUTIVE SUMMARY**

In the 2021-22 Legislative Session, the Legislature enacted SB 218 (Jones, Ch. 217, Stats. 2022), which established processes by which a for-profit California corporation may remedy corporate actions that failed to comply with technical legal requirements when originally undertaken – for example, an issuance of stock that was permitted under the articles of incorporation but failed to meet all of the corporate formalities. SB 218 thus provided clarity to for-profit corporations, but the bill did provide the ratification mechanisms to non-profit and cooperation corporations organized under similar, but distinct, legal frameworks.

This bill would fill the gap and provide the same ratification mechanisms established in SB 218 to nonprofit and cooperative corporations organized under California law. The substantive provisions of the bill are identical to those in SB 218, with the only changes made as necessary to account for the differences in corporate form (e.g., using the term “members” instead of “shareholders” as the concept pertains to nonprofit corporations and deleting provisions applicable to “shareholders” and “securities” which apply to for-profit corporations but not nonprofit corporations).

This bill is sponsored by the Nonprofit Organizations Committee of the Business Law Section of the California Lawyers Association and is supported by the California Society

of Enrolled Agents. There is no known opposition. This bill was passed out by the Senate Banking and Financial Institutions Committee with a vote of 7-0.

### PROPOSED CHANGES TO THE LAW

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, tit. 1, div. 2., §§ 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, tit. 1, div. 3, pt. 2, §§ 12200 et seq.)
- 3) Authorizes nonprofit and cooperative corporations to file a “certificate of correction” by which the corporation may correct a misstatement of fact, defect in the execution of a document, or other error or defect in any agreement, certificate, or other instrument filed under the Nonprofit or Cooperative Corporation Laws, except where the correction would alter the wording of any written consent adopted by the corporation’s board of directors or members or delegates, or effect a corrected amendment of the corporation’s articles when such amendment would not have complied with the requirements of the Nonprofit or Cooperative Corporation Laws at the time the document being corrected was filed. (Corp. Code, §§ 5007, 12213.)
- 4) 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, § 119.)

This bill:

- 1) Establishes, for nonprofit and cooperative corporations, two retroactive ratification mechanisms identical to those provided to for-profit corporations.
- 2) Defines, for purposes of 1), the following terms:
  - a) “Corporate action” means any action or purported action of the board, any action or purported action of the members, and/or any other action or transaction taken, or purportedly taken, by or on behalf of the corporation.

- b) "Higher approval standard" means any provision set forth in the relevant division or the corporations' articles, bylaws, or a plan or agreement in effect at the time the original corporate act was taken or purportedly taken, that required a higher proportion of votes than a standard corporate action, required a greater proportion of directors or members to constitute a quorum than for a standard corporate action, placed specific limitations or requirements related to specific consent, or required separate action of any specified persons or holders of securities not required at the time of the ratification pursuant to 1).
  - c) "Security" is a share, option, or other security of a corporation.
  - d) "Authorized person, for purposes of the action in 4), is the corporation, any successor entity to the corporation, any director, any member, or any other person, so long as the other person claims to be substantially and adversely affected by the ratification of a corporate action pursuant to 1).
- 3) Provides an internal mechanism by which a nonprofit or cooperative corporation may ratify an otherwise-lawful corporate act, as follows:
- a) The board of directors and, where applicable, members and other individuals whose consent was necessary to take the original action, may adopt a resolution that sets forth information including the corporate action to be ratified and the nature of the noncompliance or purported noncompliance of the action.
  - b) The resolution must be adopted through the same means and under the same conditions as the original act to be ratified (e.g., if the original act required a two-thirds vote, the resolution must be adopted by a two-thirds vote).
  - c) If the act being ratified would have required the filing of an instrument with the Secretary of State or the ratification would cause a previously filed instrument to become materially inaccurate or incomplete, the corporation must file a certificate of ratification with the Secretary of State.
  - d) The Secretary of State may refuse a filing if the instrument would render a prior filing inaccurate, ambiguous, or unintelligible. If the Secretary of State refuses the filing, the corporation must seek ratification through the superior court under 4).
  - e) Notice of a ratification must be provided to members regardless of whether member approval was required for the ratification.
- 4) 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.
- a) The superior court may make any order concerning the corporate action as justice and equity may require.

- b) A petition following a purported ratification under 3) must be filed within 180 days of the provision of notice under 3)(c).
  - c) The corporation must be served with the petition, and the superior court may order service on other individuals and permit those persons to intervene in the action.
  - d) If a corporate action validated by the superior court would have required the filing of an instrument with the Secretary of State or the ratification would cause a previously filed instrument to become materially inaccurate or incomplete, the corporation must file a certificate of ratification with the Secretary of State.
- 5) Provides that, except as otherwise adopted by a resolution under 3) or as stated by a superior court under 4), a corporate ratification or validation dates back to the date of the original corporate act.
- 6) Requires a nonprofit or cooperative corporation to retain records related to a ratification or validation.
- 7) 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.

## COMMENTS

### 1. Author's comment

According to the author:

This bill, SB 446, would, for California nonprofit and cooperative corporations, create a statutory mechanism to 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. It thus creates greater certainty for the operation and existence of California nonprofit and cooperative corporations.

### 2. This bill extends to nonprofit and cooperative corporations the existing mechanisms for ratifying potentially defective corporate acts available to for-profit corporations

Prior to 2022, none of California's corporation laws had a clear statutory procedure by which a corporation could ratify or validate potentially defective corporate acts retroactively to the date of the original corporate action. This meant, in situations where the board or shareholders acted in good faith to take an action, but unintentionally

failed to follow the necessary corporate formalities, a corporate action could still be invalid years later, and a corporation had no way to retroactively fix it. This ambiguity could harm shareholders and effectively hamstring a corporation if, for example, the board was defectively formed in the first instance; there would be no competent board to correct the mistake.

In 2022, the Legislature enacted SB 218 (Jones, Ch. 217, Stats. 2022), which implemented, for for-profit corporations formed under the General Corporation law,<sup>1</sup> two mechanisms by which a corporation could ratify a technically noncompliant act retroactive to the date the act was intended to be accomplished. To be clear, these mechanisms were not intended to ratify improper, self-dealing, or illegal acts, but rather for acts that were appropriate for the corporation to take but failed to comply with all the requisite corporate formalities.<sup>2</sup>

The first mechanism is purely internal: the corporation may retroactively ratify the potentially defective corporate act through the same procedure that was required to approve the initial act.<sup>3</sup> Thus, if the original purported corporate act required approval of only the board, the board could approve a resolution to accomplish the ratification; but if the original purported act required a higher approval standard, such as a shareholder vote, the resolution ratification would also be subject to the higher approval standard.<sup>4</sup> A corporation that accomplishes a ratification through this procedure must provide notice of the ratification to each member and holder of shares purportedly issued at the time of the ratification and, if the original action would have required the filing of an instrument with the Secretary of State, file a certificate of ratification to make, amend, or correct any instrument filed; the Secretary of State may refuse to file the certificate, in which case the corporation must proceed with the court procedure<sup>5</sup>

The second mechanism allows any authorized person – which includes the corporation and any successor entity, any director, any shareholder or holder of shares purportedly issued, and any other person who was substantially and adversely affected by a ratification accomplished under the first mechanism – to petition the superior court for an order determining the validity of a corporate action.<sup>6</sup> The court, sitting in equity, has broad discretion to make any order concerning the corporate action as required by justice and equity.<sup>7</sup> The procedure permits the court to order affected persons to be served or notified of the action and to intervene in the action as necessary. As with the resolution route, the corporation must file a certificate of ratification with the Secretary

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<sup>1</sup> Corp. Code, tit. 1, div. 1, §§ 100 et seq.

<sup>2</sup> See Corp. Code, § 119(a)(5).

<sup>3</sup> *Id.*, § 119(b).

<sup>4</sup> *Ibid.*

<sup>5</sup> *Id.*, § 119(c), (d).

<sup>6</sup> *Id.*, § 119(e).

<sup>7</sup> *Id.*, § 119(e)(2).

of State if the original document memorializing the corporate act required a filing or the ratification renders an existing document materially inaccurate or incomplete.<sup>8</sup>

This Committee passed a version of SB 218 that was substantially similar to the final version. The measure, as enacted, authorized a broader range of persons to file a petition for ratification and added additional procedural protections for litigants and shareholders.

This bill extends the ratification measures currently available to for-profit corporations to nonprofit and cooperative corporations. The measures are identical but for terminology changes necessary to reflect the differences in corporate structures and similar technical differences.

### 3. Arguments in support

According to the Nonprofit Organizations Committee of the Business Law Section of the California Lawyers Association, the sponsor of the bill:

There is significant uncertainty under California corporate law for profit and cooperative corporations about how to correct corporate actions that failed to comply with legal requirements when originally undertaken. The bill is needed because, while this uncertainty was addressed for for-profit California corporations in SB 218 (Jones), enacted in 2022, it has not been addressed for nonprofit and cooperative corporations.

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.

SB 446 is modeled on SB 218 which was enacted to create a statutory mechanism that allows California *for-profit* corporations to ratify or petition the superior court to validate noncompliant but otherwise lawful corporate actions, bringing California in line with several other states that have established a framework to ratify or validate such actions. SB 446 extends the same statutory mechanism to *nonprofit and cooperative* corporations, thereby creating greater certainty for the operation and existence of California nonprofit and cooperative corporations.

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<sup>8</sup> *Id.*, § 119(f).

**SUPPORT**

California Law Association, Business Law Section, Nonprofit Organizations Committee  
(sponsor)  
California Society of Enrolled Agents

**OPPOSITION**

None known

**RELATED LEGISLATION**

Pending Legislation: None known.

Prior Legislation:

SB 218 (Jones, Ch. 217, Stats. 2022) implemented the same two ratification methods set forth in this bill, but for for-profit corporations covered by the State's General Corporations Law (Corp. Code, tit. 1, div. 1 (§ 100 et seq.)).

SB 870 (Jones, 2020) was substantially similar to SB 218. SB 870 was held in the Banking and Financial Institutions Committee.

**PRIOR VOTES:**

Senate Banking and Financial Institutions Committee (Ayes 7, Noes 0)

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