

## **BILL ANALYSIS**

Senate Research Center

S.B. 1969  
By: Hancock  
Business & Commerce  
6/5/2019  
Enrolled

### **AUTHOR'S / SPONSOR'S STATEMENT OF INTENT**

Business entities can make procedural and technical mistakes in their operations. When certain kinds of procedural mistakes are made, there can be catastrophic effects on the continuing operation of the business.

Currently, for-profit corporations have statutory procedures for the ratification of certain defective acts or mistakes. When activated, those procedures provide for transparency and notice, including attendant notice of the effort and process to correct, shareholder approval, and judicial review requirements. The process encourages entities to fix technical glitches, rather than ignore them.

Nonprofit corporations (NPCs) face comparable problematic issues when encountering procedural mistakes. Some charitable organizations have small staffs and could be susceptible to technical errors. Ratification is never available for acts that NPCs are not legally empowered to undertake.

S.B. 1969 provides NPCs the authorization to address defective acts. Defective act ratification is conceptually derived from the Model Nonprofit Corporation Act (MNPCA) and the Delaware General Corporation Laws.

S.B. 1969 establishes procedures for the ratification of void or voidable acts, modeled on provisions of the Business Organizations Code applicable to for-profit corporations and similar provisions of the MNPCA. The bill will allow for NPCs' ratification process to have similar transparency and notice safeguards that are currently applicable to for-profit corporations, including notice of correction procedures, member approval, and judicial review. (Original Author's/Sponsor's Statement of Intent)

S.B. 1969 amends current law relating to ratification of defective corporate acts of nonprofit corporations and authorizes a fee.

### **RULEMAKING AUTHORITY**

This bill does not expressly grant any additional rulemaking authority to a state officer, institution, or agency.

### **SECTION BY SECTION ANALYSIS**

SECTION 1. Amends Chapter 22, Business Organizations Code, by adding Subchapter J, as follows:

#### **SUBCHAPTER J. RATIFICATION OF DEFECTIVE CORPORATE ACTS; PROCEEDINGS**

Sec. 22.501. DEFINITIONS. Defines "corporate statute," "defective corporate act," "district court," "failure of authorization," "time of the defective corporate act," and "validation effective time" or "effective time of the validation" for purposes of this subchapter.

Sec. 22.502. RATIFICATION OF DEFECTIVE CORPORATE ACT. Provides that, subject to Section 22.509, a defective corporate act is not void or voidable solely as a result of a failure of authorization if the act is ratified in accordance with this subchapter or validated by the district court in a proceeding brought under Section 22.512.

Sec. 22.503. RATIFICATION OF DEFECTIVE CORPORATE ACT; ADOPTION OF RESOLUTIONS. (a) Requires the board of directors of the corporation, to ratify one or more defective corporate acts, to adopt resolutions stating:

- (1) the defective corporate act or acts to be ratified;
- (2) the date of each defective corporate act;
- (3) the nature of the failure of authorization with respect to each defective corporate act to be ratified; and
- (4) that the board of directors approves the ratification of the defective corporate act or acts.

(b) Authorizes a resolution, if the corporation has members with voting rights, to also state that, notwithstanding member approval of the ratification of a defective corporate act that is a subject of the resolution, the board of directors is authorized to, with respect to the defective corporate act, abandon the ratification of the defective corporate act at any time before the validation effective time without further member action.

(c) Requires the members of the corporation, if the management of the affairs of the corporation is vested in its members under Section 22.202 (Management by Members), to adopt resolutions stating:

- (1) the defective corporate act or acts to be ratified;
- (2) the date of each defective corporate act;
- (3) the nature of the failure of authorization with respect to each corporate act to be ratified; and
- (4) that the members approve the ratification of the defective corporate act or acts.

Sec. 22.504. QUORUM AND VOTING REQUIREMENTS FOR ADOPTION OF RESOLUTIONS. (a) Provides that the quorum and voting requirements applicable to the adoption of the resolutions to ratify a defective corporate act under Section 22.503 are the same as the quorum and voting requirements applicable at the time of the adoption of the resolutions for the type of defective corporate act proposed to be ratified.

(b) Requires that the presence or approval of the larger number or portion of such governing authority, notwithstanding Subsection (a) and except as provided by Subsection (c), if in order for a quorum to be present or to approve the defective corporate act, the presence or approval of a larger number or portion of the governing authority would have been required by the governing documents of the corporation, any plan or agreement to which the corporation was a party, or any provision of the corporate statute, each as in effect at the time of the defective corporate act, to be required for a quorum to be present or to adopt the resolutions to ratify the defective corporate act, as applicable.

(c) Prohibits the presence or approval of any director elected, appointed, or nominated by a class of members that no longer exists, or by any person that is no longer a member, if the corporation has members with voting rights or if the corporation had members with voting rights at the time of the taking of the

defective corporate act, from being required for a quorum to be present or to adopt the resolutions.

**Sec. 22.505. APPROVAL OF RATIFIED DEFECTIVE CORPORATE ACT BY MEMBERS WITH VOTING RIGHTS REQUIRED; EXCEPTION.** Requires each defective corporate act ratified under Section 22.503(a), if the corporation has members with voting rights, to be submitted to such members of the corporation for approval as provided by Sections 22.506 and 22.507, unless no other provision of the corporate statute, no provision of the corporation's governing documents, and no provision of any plan or agreement to which the corporation is a party would have required approval by such members of:

- (1) the defective corporate act to be ratified at the time of that defective corporate act; or
- (2) the type of defective corporate act to be ratified at the time the board of directors adopts the resolutions ratifying that defective corporate act under Section 22.503.

**Sec. 22.506. NOTICE REQUIREMENTS FOR RATIFIED DEFECTIVE CORPORATE ACT SUBMITTED FOR APPROVAL OF MEMBERS WITH VOTING RIGHTS.** (a) Requires the notice of the time, place, if any, and purpose of the meeting, if a corporation has members with voting rights and if the ratification of a defective corporate act is required to be submitted to such members for approval under Section 22.505, to be given at least 20 days before the date of the meeting to:

- (1) each member with voting rights as of the record date of the meeting, at the address of the member as it appears or most recently appeared, as appropriate, on the corporation's records; and
- (2) each member with voting rights as of the time of the defective corporate act, except that notice is not required to be given to a member whose identity or address cannot be ascertained from the corporation's records.

(b) Requires the notice to contain:

- (1) copies of the resolutions adopted by the board of directors under Section 22.503 or the information required by Sections 22.503(a)(1)–(4); and
- (2) a statement that, on member approval of the ratification of the defective corporate act made in accordance with this subchapter, the member's right to challenge the defective corporate act is limited to an action claiming that a court of appropriate jurisdiction, in its discretion, should declare:
  - (A) that the ratification not take effect or that it take effect only on certain conditions, if that action is filed with the court not later than the 120th day after the applicable validation effective time; or
  - (B) that the ratification was not accomplished in accordance with this subchapter.

**Sec. 22.507. QUORUM AND VOTING FOR APPROVAL OF RATIFIED DEFECTIVE CORPORATE ACT AT MEETING OF MEMBERS WITH VOTING RIGHTS.** (a) Provides that, if the corporation has members with voting rights, at the meeting of such members, the quorum and voting requirements applicable to the approval of the ratification of a defective corporate act under Section 22.505 are the same as the quorum and voting requirements applicable at the time of the approval by the members of the

ratification for the type of ratified defective corporate act proposed to be approved, except as provided by this section.

(b) Requires the presence or approval of the larger number of members or of the class of members, if the presence or approval of a larger number of members or of any class of members would have been required for a quorum to be present or to approve the defective corporate act, as applicable, by the corporation's governing documents, any plan or agreement to which the corporation was a party, or any provision of the corporate statute, each as in effect at the time of the defective corporate act, to be required for a quorum to be present or to approve the ratification of the defective corporate act, as applicable, except that the presence or approval of any class that is no longer in existence or has no members, or of any person that is no longer a member with voting rights, is not required.

(c) Provides that the approval by the members with voting rights of the ratification of the election of a director requires the affirmative vote of the majority of members present at the meeting and entitled to vote on the election of the director at the time of the approval, unless the governing documents of the corporation then in effect or in effect at the time of the defective election require or required a larger number of members with voting rights or of any class of members with voting rights to elect the director, in which case the affirmative vote of the larger number of members or of the class of members is required to ratify the election of the director, except that the presence or approval of any class that is no longer in existence or has no members, or of any person that is no longer a member with voting rights, is not required.

Sec. 22.508. CERTIFICATE OF VALIDATION. (a) Requires the corporation, if a defective corporate act ratified under this subchapter would have required under any other provision of the corporate statute the filing of a filing instrument or other document with the filing officer, to file a certificate of validation with respect to the defective corporate act in accordance with Chapter 4 (Filings), regardless of whether a filing instrument or other document was previously filed with respect to the defective corporate act. Provides that the filing of another filing instrument or document is not required.

(b) Provides that a separate certificate of validation is required for each defective corporate act for which a certificate of validation is required under this section, except that two or more defective corporate acts may be included in a single certificate of validation if the corporation filed, or to comply with the applicable provisions of this code could have filed, a single filing instrument or other document under another provision of this code to effect the acts.

(c) Requires the certificate of validation to include:

(1) each defective corporate act that is a subject of the certificate of validation, including:

(A) the date of the defective corporate act; and

(B) the nature of the failure of authorization with respect to the defective corporate act;

(2) a statement that each defective corporate act was ratified in accordance with this subchapter, including:

(A) the date on which the board of directors ratified each defective corporate act; and

(B) if the corporation has members with voting rights, the date, if any, on which the members approved the ratification of each defective corporate act or, if the management of the affairs of the

corporation is vested in its members under Section 22.202, the date on which the members ratified each defective corporate act; and

(3) as appropriate:

(A) if a filing instrument was previously filed with a filing officer under the corporate statute with respect to the defective corporate act and no change to the filing instrument is required to give effect to the defective corporate act as ratified in accordance with this subchapter:

(i) the name, title, and filing date of the previously filed filing instrument and of any certificate of correction to the filing instrument; and

(ii) a statement that a copy of the previously filed filing instrument, together with any certificate of correction to the filing instrument, is attached as an exhibit to the certificate of validation;

(B) if a filing instrument was previously filed with a filing officer under the corporate statute with respect to the defective corporate act and the filing instrument requires any change to give effect to the defective corporate act as ratified in accordance with this subchapter, including a change to the date and time of the effectiveness of the filing instrument:

(i) the name, title, and filing date of the previously filed filing instrument and of any certificate of correction to the filing instrument;

(ii) a statement that a filing instrument containing all the information required to be included under the applicable provisions of this code to give effect to the ratified defective corporate act is attached as an exhibit to the certificate of validation; and

(iii) the date and time that the attached filing instrument is considered to have become effective under this subchapter; or

(C) if a filing instrument was not previously filed with a filing officer under the corporate statute with respect to the defective corporate act and the defective corporate act as ratified under this subchapter would have required under the other applicable provisions of this code the filing of a filing instrument in accordance with Chapter 4, if the defective corporate act had occurred when this code was in effect:

(i) a statement that a filing instrument containing all the information required to be included under the applicable provisions of this code to give effect to the defective corporate act, as if the defective corporate act had occurred when this code was in effect, is attached as an exhibit to the certificate of validation; and

(ii) the date and time that the attached filing instrument is considered to have become effective under this subchapter.

(d) Provides that a filing instrument attached to a certificate of validation under Subsection (c)(3)(B) or (C) does not need to be executed separately and does not need to include any statement required by any other provision of this code that the instrument has been approved and adopted in accordance with that provision.

Sec. 22.509. ADOPTION OF RESOLUTIONS; EFFECT ON DEFECTIVE CORPORATE ACT. Prohibits each defective corporate act ratified in accordance with this subchapter, on or after the validation effective time, unless determined otherwise in an action brought under Section 22.512, from being considered void or voidable as a result of the failure of authorization described by the resolutions adopted under Sections 22.503 and 22.504, and requires the effect to be retroactive to the time of the defective corporate act.

Sec. 22.510. NOTICE TO MEMBERS FOLLOWING RATIFICATION OF DEFECTIVE CORPORATE ACT. (a) Requires that notice of the ratification, if the management of the affairs of a corporation is vested in its members under Section 22.202 or if a corporation has members with voting rights, for each defective corporate act ratified by the governing authority under Sections 22.503 and 22.504, be given promptly to:

(1) each member having voting rights as of the date the governing authority adopted the resolutions ratifying the defective corporate act; or

(2) each member having voting rights as of a date not later than the 60th day after the date of adoption, as established by the governing authority.

(b) Requires that notice under this section be sent to the address of a member described by Subsection (a)(1) or (a)(2) as the address appears or most recently appeared, as appropriate, on the records of the corporation.

(c) Requires that notice under this section also be given to each member having voting rights as of the time of the defective corporate act, except that notice is not required to be given to a member whose identity or address cannot be ascertained from the corporation's records.

(d) Requires the notice to contain:

(1) copies of the resolutions adopted by the governing authority under Section 22.503 or the information required by Section 22.503(a)(1)–(4) or 22.503(c)(1)–(4), as applicable; and

(2) a statement that, on ratification of the defective corporate act made in accordance with this subchapter, the member's right to challenge the defective corporate act is limited to an action claiming that a court of appropriate jurisdiction, in its discretion, should declare:

(A) that the ratification not take effect or that it take effect only on certain conditions, if the action is filed not later than the 120th day after the later of the applicable validation effective time or the time at which the notice required by this section is given; or

(B) that the ratification was not accomplished in accordance with this subchapter.

(e) Provides that, notwithstanding Subsections (a)-(d), notice is not required to be given under this section to a person if notice of the ratification of the defective corporate act is given to that person in accordance with Section 22.506.

(f) Requires notice to members with voting rights as of the time of the defective corporate act, for purposes of Sections 22.505, 22.506, and 22.507 and this

section, be treated as notice to such members for purposes of Sections 6.051 (General Notice Requirements), 6.052 (Waiver of Notice), 6.053 (Exception), 6.201 (Unanimous Written Consent to Action), 6.202 (Action by Less Than Unanimous Written Consent), 6.203 (Delivery of Less Than Unanimous Written Consent), 6.204 (Advance Notice Not Required), 6.205 (Reproduction or Electronic Transmission of Consent), and 22.156 (Notice of Meeting).

(g) Authorizes the notice required by this section, if the ratification of a defective corporate act has been approved by the members acting under Section 6.202, to be included in any notice required to be given under Section 6.202(d) (relating to requiring an entity to notify each owner or member who did not sign a consent) and, if included:

(1) is required to be sent to the members entitled to the notice under Section 6.202(d) and all other members otherwise entitled to the notice under Subsection (a); and

(2) is not required to be sent to members who signed a consent described by Section 6.202(b) (relating to the authorization of the certificate of formation for a filing entity to authorize certain actions).

Sec. 22.511. RATIFICATION PROCEDURES OR COURT PROCEEDINGS CONCERNING VALIDATION NOT EXCLUSIVE. (a) Provides that ratification of an act or transaction under this subchapter or validation of an act or transaction as provided by Sections 22.512 through 22.515 is not the exclusive means of ratifying or validating any act or transaction taken by or on behalf of the corporation, including any defective corporate act, or of adopting or endorsing any act or transaction taken by or in the name of the corporation before the corporation exists.

(b) Provides that the absence or failure of ratification of an act or transaction in accordance with this subchapter or of validation of an act or transaction as provided by Sections 22.512 through 22.515 does not, of itself, affect the validity or effectiveness of any act or transaction properly ratified under common law or otherwise, nor does it create a presumption that any such act or transaction is or was a defective corporate act.

Sec. 22.512. PROCEEDING REGARDING VALIDITY OF DEFECTIVE CORPORATE ACTS. (a) Authorizes certain entities to bring an action under this section, including the corporation, any successor entity to the corporation, any member of the corporation's board of directors or other person having fiduciary responsibility in relating to the actions of the corporation, any member with voting rights, or any record member with voting rights as of the time a defective corporate act was ratified in accordance with this subchapter.

(b) Authorizes the district court, on application by a person described by Subsection (a), subject to Section 22.515, to:

(1) determine the validity and effectiveness of any defective corporate act ratified in accordance with this subchapter;

(2) determine the validity and effectiveness of the ratification of any defective corporate act in accordance with this subchapter;

(3) determine the validity and effectiveness of any defective corporate act not ratified under this subchapter or any defective corporate act not ratified effectively under this subchapter;

(4) determine the validity of any corporate act or transaction; and

(5) modify or waive any of the procedures set forth in Sections 22.501 through 22.511 to ratify a defective corporate act.

(c) Authorizes the district court, in connection with an action brought under this section, to:

(1) declare that a ratification in accordance with and pursuant to this subchapter is not effective or that the ratification is effective only at a time or on conditions as specified by the district court;

(2) validate and declare effective any defective corporate act and impose conditions on such a validation;

(3) require measures to remedy or avoid harm to any person substantially and adversely affected by a ratification under this subchapter or from any order of the district court pursuant to this section, excluding any harm that would have resulted had the defective corporate act been valid when approved or effectuated;

(4) order the filing officer to accept for filing an instrument with an effective date and time as specified by the court, which may be before or subsequent to the time of the order;

(5) if the corporation has members with voting rights, order that a meeting of such members be held and determine the right and power of persons to vote at the meeting;

(6) declare that a defective corporate act validated by the court is effective as of the time of the defective corporate act or at such other time as determined by the court; and

(7) make any other order regarding such matters as the court considers appropriate under the circumstances.

(d) Authorizes the district court, in connection with the resolution of matters under Subsections (b) and (c), to consider:

(1) whether the defective corporate act was originally approved or effectuated with the belief that the approval or effectuation was in compliance with the provisions of the corporate statute or the governing documents of the corporation;

(2) whether the corporation and the corporation's board of directors have treated the defective corporate act as a valid act or transaction and whether any person has acted in reliance on the public record that the defective corporate act was valid;

(3) whether any person will be or was harmed by the ratification or validation of the defective corporate act, excluding any harm that would have resulted had the defective corporate act been valid when it was approved or took effect;

(4) whether any person will be harmed by the failure to ratify or validate the defective corporate act; and

(5) any other factors or considerations the district court considers just and equitable.

Sec. 22.513. EXCLUSIVE JURISDICTION. Provides that the district court has exclusive jurisdiction to hear and determine any action brought under Section 22.512.

Sec. 22.514. SERVICE. (a) Provides that service of an application filed under Section 22.512 on the registered agent of a corporation or in any other manner permitted by applicable law is considered to be service on the corporation, and no other party need be joined in order for the district court to adjudicate the matter.

(b) Authorizes the district court, if an action is brought by a corporation under Section 22.512, to require that notice of the action be provided to other persons identified by the court and permit those other persons to intervene in the action.

Sec. 22.515. STATUTE OF LIMITATIONS. (a) Provides that this section does not apply to an action asserting that a ratification was not accomplished in accordance with this subchapter or any person to whom notice of the ratification was not given as required by Sections 22.506 and 22.510.

(b) Provides that, notwithstanding any other provision of this subchapter:

(1) an action claiming that a defective corporate act is void or voidable due to a failure of authorization identified in the resolutions adopted in accordance with Section 22.503 is prohibited from being filed in or must be dismissed by any court after the applicable validation effective time; and

(2) an action claiming that a court of appropriate jurisdiction, in its discretion, should declare that a ratification in accordance with this subchapter not take effect or that the ratification take effect only on certain conditions is prohibited from being filed with the court after the expiration of the 120th day after the later of the validation effective time or the time that any notice required to be given under Section 22.510 is given with respect to the ratification.

(c) Provides that, except as otherwise provided by a corporation's governing documents, for purposes of this section, notice under Section 22.510 that is:

(1) mailed is considered to be given on the date the notice is deposited in the United States mail with postage paid in an envelope addressed to the member at the member's address appearing or most recently appearing, as appropriate, in the records of the corporation; and

(2) transmitted by facsimile or electronic message is considered to be given when the facsimile or electronic message is transmitted to a facsimile number or an electronic message address provided by the member, or to which the member consents, for the purpose of receiving notice.

Sec. 22.516. NOTICE TO ATTORNEY GENERAL. (a) Defines "charitable entity" for purposes of this section.

(b) Provides that an action brought under Section 22.512 that involves a charitable entity is considered a "proceeding involving a charitable trust" to which Chapter 123 (Attorney General Participation in Proceedings Involving Charitable Trusts), Property Code, applies.

SECTION 2. Amends Section 4.153, Business Organizations Code, as follows:

Sec. 4.153. FILING FEES: NONPROFIT CORPORATIONS. Requires the secretary of state, for a filing by or for a nonprofit corporation, to impose the following fees:

(1)–(12) makes no changes to these subdivisions;

(13) makes a nonsubstantive change to this subdivision;

(14) for filing a certificate of validation, \$5, plus the filing fee imposed for filing each new filing instrument that is attached as an exhibit to the certificate of validation under Section 22.508(c)(3)(C); and

(15) creates this subdivision from existing text and makes no further changes.

SECTION 3. Effective date: September 1, 2019.