

# Daily Journal

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PERSPECTIVE

## Ruling clarifies ability to ratify corporate acts

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In *Paul Nguyen v. View, Inc.*, the Delaware Court of Chancery ruled that Section 204 of the General Corporation Law of the State of Delaware could not be used to ratify a corporate act taken by a corporation that a majority of its stockholders refused to authorize because that refusal was not a defective corporate act.

In 2009, two years after conducting a round of Series A preferred stock financing, View presented a proposal to its stockholders for a round of Series B preferred stock financing. Nguyen, the founder and majority stockholder of View, consented to the Series B financing, but subsequently revoked his consent when he determined the restated corporate governance documents contemplated in connection with the Series B financing would be unfavorable to, and provide less protection for, him as a stockholder.

View disputed Nguyen's right to revoke his consent and proceeded with several additional rounds of financing based on its belief that Nguyen's initial consent was valid. Nguyen then initiated claims against View in arbitration. Despite pending arbitration, View continued to move forward with the financings and raised approximately \$500 million.

The decision from the arbitrator concluded Nguyen had validly revoked his consent, and that the closing of the Series B financing was "void and invalid." The decision invalidated

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the corporate documents and transaction documents related to the Series B financing and subsequent rounds of financing.

With its capital structure in turmoil, View proceeded with several corporate acts in an attempt to ratify the charter amendments and corporate acts involving the Series B financing pursuant to Section 204. In total, View filed two certificates of correction and 22 certificates of validation pursuant to Section 204.

Nguyen filed an action under Section 205 of the DGCL seeking a declaration that View's attempts to ratify the corporate acts and transaction documents associated with the financing were invalid and improper.

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Section 204 provides, in pertinent part, that "no defective corporate act or putative stock shall be void or voidable solely as a result of a failure of authorization if ratified as provided in this section or validated by the Court of Chancery in a proceeding brought under" Section 205.

The court emphasized that, by definition, Section 204 allows a corporation to ratify a defective corporate act only if the act the corporation seeks to ratify was within the corporation's "power at the time such act was purportedly taken." However, View proceeded with the Series B financing without the required consent of the majority holder of common stock, who had considered the transaction and specifically declined to approve it. Thus, at the time View engaged in the defective corporate acts, it lacked the corporate power to do so.

The court distinguished a "failure of authorization," or a failure to comply with the DGCL or the corporation's governing documents in obtaining stockholder approval of a transaction, with a transaction that is void because the corporation's stockholders deliberately rejected it. A decision to the contrary would allow a corporation to ratify an act that stockholders had expressly voted to reject and to certify that act as effective on the date the stockholders rejected it.

Further, the court rejected View's argument that the ratification should be valid because the corporation's other stockholders could have converted their preferred stock to common stock of the corporation prior to the Series B financing and then validly approved the financing. The court reiterated that Section 204 cannot be used to authorize retroactively an act that was never taken but that the corporation now wishes had occurred, or to

backdate an act that did occur but that the corporation wishes had occurred as of an earlier date. In other words, Section 204 does not permit a corporation to turn back time or alter a vote in which the stockholders expressly and validly reject a proposed corporate action.

The court then highlighted several instances where Delaware courts have allowed corporations to ratify corporate acts for failure of authorization, including (i) a board failure to adhere to the corporate formalities required to authorize a stock issuance; (ii) technical dating discrepancies in stockholder consents; (iii) improper notice to stockholders; (iv) missing records issues, timing issues, authority issues, and validity of board and stock issues; and (v) a failure properly to seek the required approval from either a board of directors or stockholders. None of those instances involved the use of Section 204 to ratify a transaction previously rejected by the stockholders.

View provides a reminder of the original purpose of Section 204 and, notwithstanding its intentional limitations, its wide-ranging benefits. First, to the extent any practitioner has believed, or advised his or her clients, that Section 204 could be used to ratify corporate acts that were unauthorized by stockholders having at least the number of votes necessary to authorize the acts, the court made it clear that such unauthorized acts could not be ratified. Therefore, if those stockholders are unwilling to

authorize a proposed transaction, then the corporation should either negotiate specific terms with those stockholders until they agree to authorize the transaction or propose an entirely different transaction structure that satisfies those stockholders. Ignoring the stockholders' rejection of a proposed corporate act with the understanding that the proposed act can be ratified after the corporation's capital structure has changed sufficiently is not, to the extent the action needs to be effective as of a prior date, viable.

Second, Delaware courts will not explore a hypothetical scenario that would permit ratification under Section 204 had that scenario occurred. Instead, at any time the corporation is considering a significant transaction, the corporation and its stockholders should explore all potential transaction structures and select

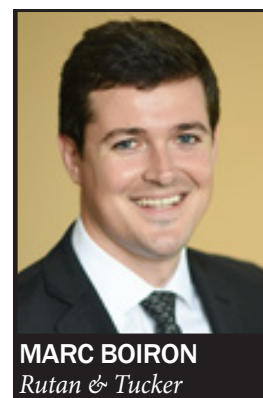
the structure, if any, that permits them to comply with Delaware law and the corporation's governing documents and achieve their business goals. Therefore, as is always the case, the terms of governing documents agreed to among founders and early-stage investors are crucial as they will determine the flexibility of various constituencies when considering corporate actions.

Lastly, the narrow limitation on Section 204 imposed by View has little impact on its broad applicability and important role for early-stage companies. When dealing with early-stage companies, especially those involved in equity crowdfunding (such as Regulation CF or Regulation A+) where the number of stockholders easily can be in the hundreds, the ability to fix capital structure or corporate governance issues retroactively is

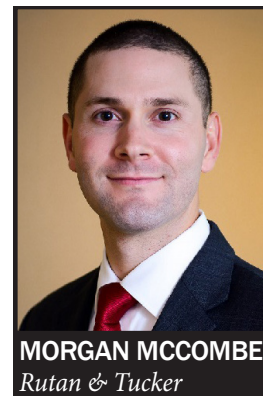
crucial. In most instances, where corporate approvals have simply not been obtained, rather than having been rejected, Section 204 will provide a viable path forward for those companies.

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