



ATTORNEYS AT LAW

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Changes to North Carolina Business Corporation Act Affecting Defective Share Issuances and Other Corporate Acts

Changes to the North Carolina Business Corporation Act (the “Act”) (N.C. Gen. Stat. § 55-1-01, *et. seq.*) dealing with defective share issuances and other corporate actions will take effect on October 1, 2018. Senate Bill 622, which was signed into law on June 22nd of this year, makes changes to nine (9) topics governed by the Act, including a change in the manner and effect of a corporation’s ratification of a prior corporate act, including a share issuance, that would otherwise be void or voidable. Senate Bill 622 (Session Law 2018-45) (2018), available at: <https://www.ncleg.net/Sessions/2017/Bills/Senate/PDF/S622v5.pdf>.

Under Prior North Carolina Law, a Defective Share Issuance Could Not Be Cured By Ratification and the Original Issuance Was Void.

It is not uncommon for a North Carolina corporation to take corporate action without following all required corporate formalities. Prior to Senate Bill 622 taking effect, if a corporation’s board of directors issued more shares than were authorized by the corporation’s articles or failed to secure the required approval of a particular shareholder when issuing shares, the corporation faced the risk that a North Carolina court would hold the share issuance void. In fact, North Carolina case law indicates that even a later ratification of the corporate act is not sufficient to cure the defect. Such a result can have harsh – sometimes devastating –

consequences for a person who relied on the action's validity in making subsequent economic decisions, even where the corporation is required to return the consideration paid for the shares. For example, if a person believed themselves to be a shareholder, only later to learn that they did not in fact own any interest in the corporation, the return of consideration paid prior to an appreciation in the value of the shares would do little to put the person in the position they believed they were in.

Changes to the Act Provide a Corporation a Non-Exclusive Means to Validate Defective Share Issuances and Other Corporate Actions.

Once changes to the Act take effect, a “defective corporate action shall not be void or voidable if ratified in accordance with N.C. Gen. Stat. § 55-1-61 or validated in accordance with N.C. Gen. Stat. § 55-1-67.” N.C. Gen. Stat. § 55-1-61(a)(2018). The new law defines a “defective corporate action” to include an action “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 or authorization,” including an overissue of shares. N.C. Gen. Stat. § 55-1-60(3). See N.C. Gen. Stat. § 55-1-60(5) (defining “Overissue”).

Ratification under the Act requires that the board of directors take corporate action that states all of the following: (1) the defective action to be ratified, including the number and type of shares purportedly issued, if applicable; (2) the date of the defective corporation action; (3) the nature of the failure of authorization; and (4) the board of director's approval of the ratification of the defective corporate act. N.C. Gen. Stat. § 55-1-62(a). If the defective action requires shareholder approval, including under the Act, the articles of incorporation or bylaws, any corporate resolution, or any plan or agreement, the shareholders must approve the defective

action after the board has done so. N.C. Gen. Stat. § 55-1-61(c). The new law also provides that voting and quorum requirements applicable to the ratification are the same as the voting and quorum requirements applicable to the corporate action to be ratified (N.C. Gen. Stat. §§ 55-1-63(a)) and that all valid and putative shareholders, whether or not entitled to vote, are entitled to prompt notice of the ratification. N.C. Gen. Stat. §§ 55-1-64(a).

Superior Courts in North Carolina, including the Business Court, will have the authority under the Act to validate the effectiveness of any corporate action or defective corporate action, as well as any ratification thereof. N.C. Gen. Stat. § 55-1-67(a). However, the statute of limitations under the new law is 120 days from the time the ratification becomes effective, meaning that any claims brought by those opposing the ratification that are not filed within the permissible period are time barred. N.C. Gen. Stat. § 55-1-67(d).

Impact of New Ratification Provisions on Corporations and Defective Corporate Acts.

By ratifying the action, a corporation can make the previously defective share issuance “valid as of the time it was purportedly issued,” along with any subsequent corporate action taken in reliance on the defective share issuance or resulting directly or indirectly from the defective share issuance, valid from the time the subsequent action was taken. N.C. Gen. Stat. § 55-1-65 (1)-(3). Additionally, a corporation’s decision to ratify a corporate action under the Act does not (1) affect the validity or effectiveness of ratification done under common law or other; or (2) create any presumption that the act or transaction in question was, in fact, defective. N.C. Gen. Stat. § 55-1-61(b). As a result, the Act’s revisions provide a corporation with a non-exclusive option for ratifying previous corporate actions, without requiring corporation’s to

weigh the risk that doing so will amount to an admission that the original action was not properly taken.

Additional Changes to Chapter 55

Senate Bill 622 also makes changes to, *inter alia*, the following topics: (1) allowing the inclusion in the articles of incorporation the right for a corporation to limit or eliminate a director or officer's duty to bring certain business opportunities to the corporation; (2) requiring, under certain circumstances, a holder of two or more series of a class of shares to vote the shares together as a single voting group for a proposed plan or merger or conversion; (3) removing the ten (10) year statutory limits on voting trusts; (4) seeking to attract qualified candidates to serve on boards of directors by requiring a challenger to board compensation to overcome a presumption of fairness and prohibiting the retroactive impairment of rights to indemnification and advanced expenses; (5) allowing for the cancellation of shares or interests at merger closing under certain entity merger statutes; (6) creating a procedure that allows the offeror to consummate a merger without a shareholder vote if the offeror has acquired enough shares to approve the merger if it were to go to a shareholder vote; (7) allowing short-form mergers of subsidiary corporations into parent entities without a shareholder vote where the parents is not a corporation and owns at least ninety percent (90%) of the subsidiary's shares; and (8) providing for appraisal rights of shareholders with non-voting shares where the holder provides notice of intent to demand appraisal rights prior to the corporate action. See Business Corporations Committee of the Business Law Section of the North Carolina Bar Association, Summary of 2018 Amendments to the North Carolina Business Corporation Act (July 10, 2018). The

majority of changes to the Act are based on changes to the Model Business Corporation Act, while other changes are based on laws passed in other states, such as Delaware and Nevada.

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