SPONSOR: Rep. Wilson-Anton

HOUSE OF REPRESENTATIVES
152nd GENERAL ASSEMBLY

HOUSE AMENDMENT NO. 1
TO
SENATE BILL NO. 114

AMEND Senate Bill No. 114 on line 281 by deleting “affects” and inserting in lieu thereof “effects”.

FURTHER AMEND Senate Bill No. 114 on lines 286 through 287 by deleting “increase or decrease the authorized number of shares of a class of capital stock or an amendment to”.

FURTHER AMEND Senate Bill No. 114 on line 291 between “(B)” and “at” by inserting the following:

“the corporation has received a delisting notice from such national securities exchange and such amendment becomes effective before the final deadline to cure in the delisting notice, (C) the amendment concomitantly decreases the authorized number of shares of capital stock, and (D)”.

FURTHER AMEND Senate Bill No. 114 on line 292 between “section,” and “a” by inserting “(i)” therein.

FURTHER AMEND Senate Bill No. 114 on line 294 by deleting “(C)” and inserting in lieu thereof “(ii)”.

FURTHER AMEND Senate Bill No. 114 on line 294 by deleting “increases or”.

SYNOPSIS

This Amendment conforms the language that Senate Bill No. 114 adds to § 242 of Title 8 to its stated intent, which is to allow companies facing a threat of delisting to engage in a reverse split by meeting a lower threshold for the required stockholder vote. As is fully explained below, this Amendment prevents SB 114 from creating an indirect method for a corporation to free up more authorized shares that can be dilutive to existing stockholders. This Amendment also corrects an instance of the word “affects” to “effects” and makes corresponding changes to the internal designations within § 242(d)(2) of Title 8.

“Shares outstanding” are the total number of shares held by all stockholders. A stockholder’s ownership in the corporation is a fraction reflected by the number of shares held divided by the number of shares outstanding. If a stockholder owns 100 shares and there are 1,000 shares outstanding, then the stockholder owns one tenth of the corporation.

“Authorized shares” are the number of shares that a corporation can issue. A corporation that has 10,000 authorized shares and 1,000 shares outstanding can issue another 9,000 shares. “Headroom” is the difference between the shares outstanding and the authorized shares.

Existing stockholders care about headroom because the issuance of more shares dilutes their ownership. If the corporation with 1,000 shares outstanding issues another 1,000 shares, then the stockholder who owns 100 shares (which previously represented 10% of the shares outstanding) will continue to own 100 shares; however, because of the additional issued shares, the stockholder's proportionate ownership of the corporation has been reduced (now represents 5% of the shares outstanding). If the corporation issued shares as part of a transaction that increased its overall value, then the stockholder may now own a 5% stake that is worth more and may have come out ahead. If not, then the stockholder has lost value, so the stockholder’s stake has been diluted.

The more headroom that a corporation has, the greater the risk of dilution is for stockholders. Due to the significance of authorized shares, Delaware has always required the vote of a majority of the outstanding shares to increase the authorized shares. A corporation must ask all of its stockholders for permission to create more headroom, since it can be used to dilute the stockholder's shares.

Under SB 114, § 242 will allow a corporation to engage in a reverse split that reduces the number of its issued shares by a majority vote of the stockholders who participate in person or by proxy at a meeting. That standard is known as a majority of a quorum. For a public company, the number of stockholders who participate in person or by proxy at a meeting is always less than the outstanding shares. At most, only 80-85% of outstanding shares participate in person or by proxy at a meeting. SB 114 thus permits a reverse split by a majority of a quorum rather than a majority of the shares outstanding.

SB 114 is intended to address a problem that some corporations have faced when they risk delisting because their stock price is too low. To increase their stock price, they wish to engage in a reverse split, but cannot get the votes necessary to approve a reverse split by a majority of the shares outstanding. Under SB 114, § 242 allows a corporation to engage in a reverse split with a majority of a quorum.

However, as provided under SB 114, § 242 is not limited to only situations when a corporation is at risk of delisting because of a low stock price. As such, under SB 114, § 242 also enables a corporation to use a reverse split approved by a majority of the quorum to create headroom.

For example, if a corporation has 400 million issued shares and 500 million authorized shares, then a corporation has 100 million shares of headroom, equal to 25% of the outstanding shares. Existing stockholders can be diluted by another 25%. Under SB 114, the corporation can engage in a reverse split with a majority of the quorum by combining every 4 outstanding shares into 1 outstanding share, thereby reducing its issued shares from 400 million to 100 million. The 500 million authorized share number remains unchanged, so the reverse split creates 300 million additional shares of headroom, for a total of 400 million shares of headroom. That is equal to 400% of the outstanding shares, post-reverse split. Existing stockholders can now be diluted by 400%.

In addition, SB 114 allows a corporation that has one class of common stock to engage in a forward split and proportionately increase its authorized shares without a stockholder vote. For example, a corporation could start out with 100 million shares outstanding and 125 million authorized shares. The corporation has headroom of 25 million shares, meaning existing stockholders can be diluted by 25%. SB 114 would allow the corporation to engage in a forward split without a stockholder vote, in which each outstanding share divides into 4 shares and increases the authorized shares proportionately. After the forward split, the corporation is in the same position as in the example above. It has 400 million issued shares and 500 million authorized shares. It has 100 million shares of headroom, and existing stockholders can be diluted by another 25%. Under SB 114, the corporation can then engage in a reverse split with a majority of the quorum by combining every 4 outstanding shares into 1 outstanding share, thereby reducing its issued shares from 400 million to back down to 100 million. The 500 million authorized shares remain unchanged, so the reverse split created a total of 400 million shares of headroom. Stockholders started out owning 100 million shares in a corporation that could be diluted by only 25 million shares, representing another 25%. But through this 2-step process, after only a single vote by a majority of the quorum, stockholders end up owning 100 million shares in a corporation that can be diluted by another 400 million shares, for another 400%.

Reverse splits have always had the effect of creating more headroom, but they have always required a majority of the outstanding shares to vote. SB 114 reduces that voting standard to only a majority of the quorum without sufficient justification for doing so. Without this Amendment, SB 114 will allow a corporation to create more headroom with a vote of only a majority of the quorum, and to do so regardless of whether the corporation faces a threat of dilution.

This Amendment corrects this problem by making the following 2 changes:

1. Adds language limiting the use of § 242 to a situation involving the risk of delisting, requiring that "the corporation has received a delisting notice from such national securities exchange and such amendment becomes effective before the final deadline to cure in the delisting notice."

2. Provides that a corporation can only use § 242 to engage in a reverse split if the number of authorized shares is reduced concomitantly.

Thus, this Amendment simultaneously addresses the 2-step transaction in which a corporation engages in a forward split to increase the authorized shares followed by a reverse split to create headroom because the authorized share number goes up and down concomitantly each time. If a corporation has 400 million issued shares and 500 million authorized shares and the corporation engages in a reverse split with a majority of the quorum voting, by combining every 5 outstanding shares into 1 outstanding share, the corporation reduces its outstanding shares from 400 million to 80 million, and the authorized shares are reduced concomitantly from 500 million to 100 million. Before the reverse split, the corporation had 100 million shares of headroom, equal to 20% of its authorized shares and 25% of the outstanding shares. After the reverse split, the corporation has 20 million shares of headroom, equal to 20% of its authorized shares and 25% of the outstanding shares.