

HOUSE BILL REPORT

SB 5004

As Passed House - Amended:

March 20, 2023

Title: An act relating to making updates to the Washington business corporation act.

Brief Description: Making updates to the Washington business corporation act.

Sponsors: Senators Pedersen, Padden, Dhingra, Mullet, Nobles and Wilson, J.; by request of Washington State Bar Association.

Brief History:

Committee Activity:

Civil Rights & Judiciary: 3/2/23, 3/10/23 [DPA].

Floor Activity:

Passed House: 3/20/23, 96-0.

Brief Summary of Bill (As Amended by House)

- Amends the Washington Business Corporation Act to specify procedures for implementing stock splits, authorize and establish requirements for holding company reorganization transactions, and clarify when shareholder approval of a merger or share exchange is not required.

HOUSE COMMITTEE ON CIVIL RIGHTS & JUDICIARY

Majority Report: Do pass as amended. Signed by 10 members: Representatives Farivar, Vice Chair; Walsh, Ranking Minority Member; Graham, Assistant Ranking Minority Member; Cheney, Entenman, Goodman, Peterson, Rude, Thai and Walen.

Staff: Edie Adams (786-7180).

Background:

This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not part of the legislation nor does it constitute a statement of legislative intent.

The Washington Business Corporation Act (WBCA) provides requirements for the creation, organization, and operation of corporations and the relationship between shareholders, directors, and officers of the corporation. Many of the provisions of the WBCA provide default rules that may be altered in the corporation's articles of incorporation or bylaws. The articles of incorporation and the bylaws are the governing documents for the corporation and set forth rules with respect to numerous organizational and operational issues.

The WBCA is modeled largely after the American Bar Association's revised Model Business Corporations Act (MBCA). The Corporate Act Revision Committee (CARC) of the Business Law Section of the Washington State Bar Association periodically reviews the WBCA and makes recommendations for updating the WBCA to keep it up to date with developments in the law and changes made to the MBCA and to corporate law in other states. The CARC recommends amendments to the WBCA to specify procedures for implementing stock splits and to authorize and establish requirements for holding company reorganization merger transactions that do not require shareholder approval.

Stock Splits.

A forward stock split occurs when a company issues additional shares of stock to current stockholders, resulting in an increase in the total number of outstanding shares by a certain ratio based on previously held shares, and a proportional decrease in the per share value. Conversely, a reverse stock split decreases the number of outstanding shares held by shareholders by a certain ratio, resulting in a proportional increase in the per-share value. In both cases, the market value of the corporation remains the same and a shareholder's proportional ownership interest also remains unchanged.

The WBCA contains minimal provisions addressing stock splits. If a corporation has only one class of outstanding shares, a corporation's board of directors may adopt an amendment to the articles of incorporation, without shareholder approval, to implement a forward split of the corporation's outstanding shares, or to implement a reverse split of outstanding shares and the number of authorized shares of that class in the same proportion.

Mergers and Holding Company Reorganization Transactions.

As a general rule, in order for two or more corporations to merge, a plan of merger must be adopted by the board of directors of each corporation that is a party to the merger, and the plan of merger must be submitted to and approved by the shareholders of each corporation. For certain types of mergers, approval by the shareholders of each corporation is not required. These include mergers between a subsidiary corporation and a parent corporation owning at least 90 percent of the outstanding shares of each class of the subsidiary corporation, and so-called "medium form mergers," which are two-step transactions that involve a front-end tender offer followed by a back-end merger that does not require shareholder approval.

A holding company reorganization is a transaction in which a new corporation becomes the

sole shareholder of an existing corporation through a merger process involving a third affiliated corporation that is formed in order to effect the transaction. The shareholders of the original corporation become shareholders of the new holding company, and the original corporation, through the merger with the third affiliated corporation, becomes a wholly owned subsidiary of the new holding company. Under the WBCA, holding company reorganizations must be approved by the shareholders of each corporation involved in the merger.

Summary of Amended Bill:

Stock Splits.

Definitions are provided for "forward stock split" and "reverse stock split." A "forward stock split" means the pro rata division of all the outstanding shares of a class of stock into a greater number of shares of the same class, whether or not the authorized shares of the class are increased in the same proportion, but does not include a share dividend. "Reverse stock split" means the pro rata combination of all the outstanding shares of a class of stock into a smaller number of shares of the same class, whether or not the authorized shares of the class are reduced in the same proportion.

A corporation may effect a stock split by amending the articles of incorporation to state the effect of the stock split on the outstanding shares of the affected class. The amendment may include a change in the authorized shares of the affected class. An amendment to the articles of incorporation to effect a stock split generally must be approved by the shareholders. Where the corporation has only one class of shares outstanding, shareholder approval is not required to effect a forward stock split, or to effect a reverse stock split if the number of authorized shares of the class is proportionately reduced by the amendment. The record date for determining the shareholders that are affected by a stock split is either the date on which the amendment takes effect, or a date fixed by the board of directors on or after the effective date of the amendment.

Provisions governing the issuance of shares by a corporation are revised to specifically state that shares may be issued as a share dividend or upon a stock split, reclassification of outstanding shares into shares of another class or series, or conversion of outstanding shares into shares of another class or series. Shares issued in these circumstances are fully paid and nonassessable.

Holding Company Reorganization Transactions.

A new provision is established governing holding company reorganization transactions involving a parent corporation, a holding company that is a direct wholly owned subsidiary of the parent corporation, and a subsidiary corporation that is an indirect wholly owned subsidiary of the parent corporation.

A parent corporation (parent constituent corporation) may merge into a single indirect wholly owned subsidiary corporation (subsidiary constituent corporation) without approval

by the shareholders of the parent constituent corporation if the surviving corporation of the merger becomes or remains a direct wholly owned subsidiary of the holding company. A number of other requirements apply, including that:

- the holding company and constituent corporations are each organized under Washington law;
- the parent constituent corporation and the subsidiary constituent corporation are the only entities to the merger;
- each share of the parent constituent corporation outstanding before the merger is converted into a share of the holding company having the same designations and relative preferences, rights, and limitations;
- the articles of incorporation and bylaws of the holding company immediately after the merger contain provisions identical to those of the parent constituent corporation, other than specified provisions;
- the surviving corporation's organizational documents must contain provisions that preserve the rights of the shareholders of the parent constituent corporation to approve corporate action that would have required approval of the shareholders had the holding company reorganization not taken place;
- the directors of the parent constituent corporation become or remain the directors of the holding company immediately after the merger; and
- the shareholders of the parent constituent corporation will not recognize gain or loss for federal income tax purposes as a result of the merger.

The board of directors of the holding company must notify each person who was a shareholder of the parent constituent corporation that the merger has become effective. The notice must include a copy of the plan of merger or a summary of the material terms and conditions of the merger and the consideration to be received by those shareholders.

Any restrictions under the chapter governing significant business transactions that applied to the parent constituent corporation or its shareholders at the time of merger apply to the holding company and its shareholders immediately after the merger becomes effective. A shareholder who was not an "acquiring person" of the parent constituent corporation immediately before the merger does not become an "acquiring person" of the holding company solely by reason of the merger.

If a shareholder of the parent constituent corporation was eligible to commence a proceeding in the right of the parent constituent corporation immediately preceding the merger, the provisions governing holding company reorganization transactions do not limit or extinguish that eligibility.

Shareholder Approval of Mergers.

The provision requiring approval of the shareholders of each corporation involved in a merger is amended to include specific exceptions for holding company reorganizations, medium-form mergers involving public companies, and mergers involving a subsidiary corporation and a parent corporation that owns at least 90 percent of the outstanding shares

of each class of the subsidiary corporation.

Appropriation: None.

Fiscal Note: Not requested.

Effective Date: The bill takes effect 90 days after adjournment of the session in which the bill is passed.

Staff Summary of Public Testimony:

(In support) The WBCA is the best tended garden in the Revised Code of Washington because a dedicated group of lawyers on the CARC volunteer their time to make sure it remains in the vanguard of statutes around the country. The CARC is charged with stewarding the continued development and modernization of the WBCA, and it follows changes to the model act, as well as developments in other leading corporate jurisdictions like Delaware, so that Washington remains a favorable jurisdiction for entity formation.

The bill addresses holding company reorganization transactions so that they may be accomplished more efficiently. Currently, these transactions would require approval of the shareholders because a merger is involved. The bill removes the need for a shareholder vote, but it includes a number of requirements to ensure that important shareholder rights are protected. The bill also addresses stock splits, which the current law does not adequately address, by providing a road map on how forward and reverse stock splits are implemented.

(Opposed) None.

Persons Testifying: Senator Jamie Pedersen, prime sponsor; and Eric DeJong, Corporate Act Revision Committee of the Washington State Bar Association Business Law Section.

Persons Signed In To Testify But Not Testifying: None.