

Why Was 25% Chosen As California's Jurisdictional Threshold For Recapitalization Transactions?

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California's securities qualification requirements and exemptions depend upon whether the offer and sale of securities is an issuer transaction, a change in rights, exchange, merger, or conversion transaction, or a nonissuer transaction. See Cal. Corp. Code §§ 25110, 25120 & 25130. Interestingly, any change in the rights, preferences, privileges, or restrictions of or on outstanding securities or any entity conversion transaction is exempt from the qualification requirement of Section 25120 unless the holders of at least 25% of the outstanding shares or unites *of any class* will be directly or indirectly substantially and adversely by the change or transaction have addresses in this state according to the records of the issuer. Cal. Corp. Code § 25103(b).

Why did the drafters of the California Corporate Securities Law land on a 25% threshold for determining? According to Marsh & Volk, *Practice Under California Securities Law*, the decision was arbitrary:

The final determination was that a figure in the neighborhood of 25% seemed to command the greatest consensus and would be a reasonable dividing line for determining when California had a sufficiently substantial interest, as opposed to the interests of other states involved, to justify it in asserting control over internal corporate transactions.

It turns out that the calculation of the 25% threshold itself can be somewhat quirky. Section 25103(d) provides that any securities controlled by any one person who controls directly or indirectly 50% or more of the outstanding securities of that class are not considered outstanding for purposes of the exemption.

This can lead to some unexpected results. For example, assume that a corporation has 100 shares issued and outstanding and that they are held by three shareholders, A, B and C. Assume further that A holds 50 shares and has a Nevada address, B holds 30 shares and has a New York address, and C holds 20 shares and has a California address. A's shares will not be considered outstanding for purposes of Section 25103(b). Thus, C will hold 40% of the outstanding shares (*i.e.*, 20 out of 50). Because C holds at least 25% of the outstanding shares and has an address in California an amendment that substantially and adversely affects the shares will not be exempt pursuant to Section 25103(b). All may not be lost, however, because it is possible that the change will be exempt

pursuant to another exemption such as Section 25103(e) or 10 CCR § 260.103.

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