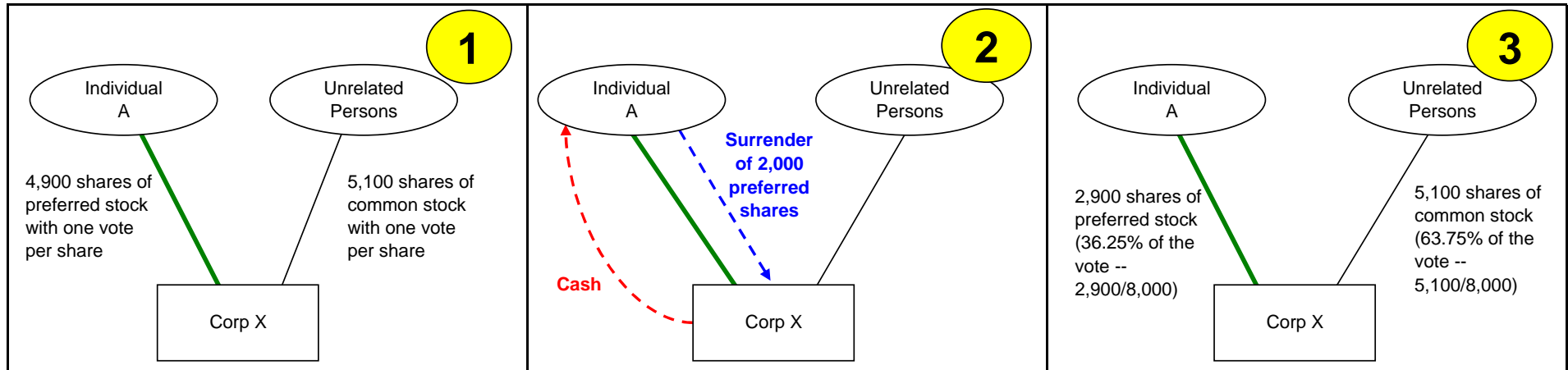


**Substantially Disproportionate
Redemption --
No Common Stock Owned**

Initial Structure

Redemption

Ending Point



A domestic corporation, X, had outstanding 5,100 shares of voting common stock and 4,900 shares of voting preferred stock. Except for minor limitations of local law, the common and preferred stock have equal voting rights. Each share of common and preferred stock has one vote in electing directors. The preferred stock is entitled to a cumulative nine percent annual dividend and is not a participating stock. All the preferred stock is owned by A, who is the founder of X and the board chairman. The preferred stock is not section 306 stock. A holds no common stock in X, either directly or constructively within the meaning of section 318. The common stock in X is widely held by persons unrelated to A.

In accord with a request from A, X redeemed 2,000 shares of the preferred stock for cash. Thus, A's vote in X was reduced from 49 percent immediately before the redemption to 36.25 percent immediately after the redemption (2,900 shares still held by A divided by 8,000 shares then outstanding). There was no plan or intent for X to redeem any of the stock held by shareholders other than A.

A owned 49 percent of the voting stock of X prior to the redemption. Eighty percent of 49 percent is 39.2 percent. Because A owned 36.25 percent of the voting stock of X after the redemption, the first "80 percent test" of section 302(b)(2)(C) is satisfied. In addition, because A owned only 36.25 percent of the voting stock of X after the redemption, the limitation of section 302(b)(2)(B) is met. Also, because this redemption was not part of a plan to redeem other stock of X, the provisions of section 302(b)(2)(D) are not violated. The question remaining is whether the second "80 percent test" of section 302(b)(2)(C), which concerns the ownership of common stock, has to be satisfied even though A owned no common stock either directly or constructively.

The additional "safeguard" provided by the second "80 percent test" of section 302(b)(2)(C) is inapplicable to A. A redemption of voting preferred stock can qualify as a substantially disproportionate redemption under section 302(b)(2) even though the redeeming shareholder does not experience a reduction in common stock ownership, if the shareholder owns no common stock either directly or constructively.