

Friction of fractions

A case study: Upexi's reverse stock split and market manipulation allegations

Reverse stock splits are often employed by companies to boost stock prices by consolidating shares. However, recent alarming trends have shown that the roundup method for fractional share disposition in these reverse split transactions can lead to significant unintended consequences, as evidenced by Upexi's recent experience. They are not alone. This case study serves as a cautionary tale for issuers considering reverse stock splits.

Transaction background

On September 27, 2024, Upexi, Inc. (NASDAQ: UPXI) announced a 20-to-1 reverse stock split after the close of the market. The split aimed to consolidate shares and improve the company's stock price to regain compliance with Nasdaq's minimum bid price requirements. In compliance with Nasdaq Listing Rule 5250(e)(7), companies must notify Nasdaq about the reverse stock split at least five business days prior to the proposed market effective date and make public disclosure at least two business days before the effective date. However, the aftermath

revealed activities that significantly impacted the company's shareholder structure and market value.

The scheme

During the four-day period from September 30, 2024, to October 3, 2024, Upexi observed the following trading activities:

- › **September 30, 2024:** On the first trading day after the announcement, Upexi observed a dramatic increase in odd lot trading volume. Specifically, 68,237 odd lots of Upexi shares traded on this day
- › **October 1, 2024:** The odd lot trading volume continued with 39,738 odd lots of Upexi shares traded
- › **October 2, 2024:** The trading volume remained high with 29,239 odd lots of Upexi shares traded
- › **October 3, 2024:** On the effective date of the reverse split, 68,005 odd lots of Upexi shares traded



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Approximately 195,000 new stockholders appeared, each purchasing a single share of Upexi's common stock in microsecond succession. The perpetrators engaged in wash trading and matched orders, positioning shares into pre-determined accounts to enable single-share sales to single-share purchasing accounts, ultimately leading to over 19% shareholder dilution due to the issuance of 202,183 additional round-up shares and a 40-fold increase in individual shareholders.

Legal action

In response, Upexi filed a complaint in the U.S. District Court for Nevada on November 22, 2024, alleging market manipulation. The company aims to identify and pursue legal action against individuals and groups involved in the alleged manipulative trading transactions.

Considerations and conclusions

This case underscores the risks associated with reverse stock splits when using the roundup method for fractional shares. Issuers must be

vigilant and consider potential manipulative schemes that can distort market value and harm shareholders.

Uniform treatment of shareholders

Most issuers strive for uniform treatment of shareholders in corporate actions events and declare such intentions in their regulatory filings. Treating registered shareholders differently from beneficial holders can expose issuers to legal challenges. For example, if the roundup of fractional shares only applies to registered holders, beneficial holders could argue that they were not treated equally and could seek legal remedies. Issuers must be aware of the potential legal consequences when considering non-uniform treatment of registered and beneficial holders.

Unintended arbitrage opportunity

The roundup option in Upexi's reverse stock split created a trading arbitrage opportunity by allowing new investors to purchase a single share before the effective date, thereby

receiving additional shares post-split.

Impact on proportional ownership

Issuers do not intend reverse splits to alter shareholders' pro rata or proportional ownership share of the company. However, mathematically, a roundup disposition will alter proportional ownership share. This effect is magnified if the arbitrage opportunity is exploited, as seen in Upexi's case.

Alternative methods and best practices for fractional share disposition

Issuers should consider alternative methods for fractional share disposition to avoid similar pitfalls:

- › **Cash paid in-lieu of fractional shares:** Pay cash in lieu of fractional shares to avoid creating an arbitrage opportunity. This method is the most straightforward option and allows all shareholders to receive fair value in exchange for their fractional share. Although some issuers may initially hesitate due to concerns about cash flow, companies can sell the

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aggregate fractional shares in the open market instead of buying them back. This approach can mitigate cash flow issues while ensuring fair treatment of shareholders.

- > **Flexible language in regulator filings:** For companies still considering rounding as a disposition option, it is advisable to include flexible language in their regulatory filings. This language should state that fractional share disposition methods may include rounding up or paying cash in lieu of fractional shares (via company buyback or open market sale), at the discretion of the board of directors. This flexibility allows the board to decide on the most appropriate method at the time of authorizing the reverse split.
- > **Clear communication and transparency:** Issuers should ensure clear communication of terms and treatment of fractional shares in their announcements and SEC filings:
 - > Clearly communicate the terms and treatment of fractional shares for shareholders.
 - > Describe the effect on both registered and street name holders.
- > **Adherence to announced terms:** Issuers must adhere to the operational terms of the reverse split, including the disposition of fractional shares, once announced. Changing these terms after the fact can create significant issues.
 - > Reversal of entitlement allocation and/or payment leads to significant shareholder confusion, negative client experience, regulatory complaints, and potential litigation.
 - > Changing terms after announcement but before allocation of entitlement leads to significant shareholder confusion and complaints.

Upexi's experience serves as a cautionary tale for issuers contemplating reverse stock splits. The company's legal action highlights the importance of addressing potential market manipulation and protecting shareholder interests. Issuers must carefully evaluate the methods used for fractional share disposition and consider alternative approaches to avoid similar pitfalls.

