APPLICATION OF SHARE-PRICE DISCOUNTS AND THEIR ROLE IN DICTATING CORPORATE BEHAVIOR: ENCOURAGING ELECTED BUY-OUTS THROUGH DISCOUNT APPLICATION

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Introduction 108
I. Shareholder Oppression 109
A. The Close Corporation 109
B. Reaction to Oppressive Behavior 110
C. Reaction of the Controlling Shareholder 112
i. Action for Involuntary Dissolution 113
ii. Election to Buy-Out the Minority Shareholder 114
iii. The Cash-Out Merger 114
II. When is Fair Value Relevant? 115I

Fair Value in Dissenter's Rights (Appraisal) Statutes 119
D. Is Fair Value Identical Regardless of the Context? 120
III. What is Fair Value? 120
A. Not Fair Market Value 121
B. Fair Value is an Approximation of Fair Market Value 122
IV. Introducing Share-Price Discounts 123
A. Minority Discounts 124

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discusses the relevance of "fair value" in the oppression context, while Section 3 addresses the meaning of "fair value" generally.

the nature of later conflict due to the familiarity among the investors.

When conflict develops, a controlling shareholder may employ a variety of tactics to harm a minority shareholder. These harmful actions are used to oppress a minority shareholder by excluding him from corporate benefits. Common tactics include terminating a minority shareholder's employment, refusal to declare corporate dividends, locking a minority shareholder out of management, and offering excessive compensation to the controlling shareholder.[5] Most often, a variety of techniques are used in tandem.

In a public corporation, a minority shareholder can avoid these abuses by selling his interest on the public market.[6] In contrast, a minority shareholder in a close corporation does not have a ready market for his shares.[7] A minority shareholder is effectively locked into his investment and cannot escape by simply selling his shares at a fair market value.

B. Reaction to Oppressive Behavior

A minority shareholder has limited options when faced with oppressive behavior that locks him out of his investment. As stated above, a close corporation is typified by the lack of a ready market for its shares.[8] However, absent a shareholder agreement to the contrary, an aggrieved minority shareholder can attempt to sell his interest through other methods. For example, he may list his interest in the business section of a local newspaper. Whatever method employed, selling an interest in a close corporation is a difficult and expensive task.[9]

Sympathetic to the plight of the minority shareholder, courts and state legislatures have developed two related causes of action for shareholders seeking to liquidate their minority interest. First, many

Super. Ct. App. Div. 1992) (remarking that "a cl

states have included oppressive behavior as grounds for seeking dissolution of a corporation under an involuntary dissolution statute.[10] Despite the statutes' names, dissolution is only one of a variety of remedies at a court's disposal.[11] Both courts and legislatures have fashioned less drastic remedies, the most common of which is the buy-out.[12] Rather than dissolve the company and end a productive business, courts often order one party to buy the shares of the other.

Second, some courts in states whose involuntary dissolution statute fails to provide for oppression have developed common law

10. *See, e.g.,* OR. REV. STAT. § 60.952(1)(b) (2005) (providing for dissolution where "[t]he directors or those in control of the corporation have acted, are acting or will act in a manner that is illegal, oppressive or fraudulent").

11. *Id.* (providing twelve alternatives to dissolution).

12. The Supreme Court of Oregon listed the following alternative remedies for oppressive conduct:

> (a) The entry of an order requiring dissolution of the corporation at a specified future date, to become effective only in the event that the stockholders fail to resolve their differences prior to that date;
>
> (b) The appointment of a receiver, not for the purposes of dissolution, but to continue the operation of the corporation for the benefit of all the stockholders, both

actions for oppression.[13] For example, some courts have imposed fiduciary duties on controlling shareholders of close corporations, the breach of which gives rise to a cause of action.[14]

ii. Election to Buy-Out the Minority Shareholder

In states that provide for it, a controlling shareholder can exercise his option to buy-out the complaining shareholder and avoid oppression litigation altogether.[22] This alternative has the advantage of avoiding litigation concerning the wrongdoing of a controlling shareholder. Once an election is made, valuation is the only issue remaining for dispute. A controlling shareholder can eliminate the complaining minority shareholder more quickly, avoiding further negative collateral effects on the operation of the business that result from oppression disputes.

Most importantly, an election to buy-out forecloses the possibility that the corporation will be dissolved if the controlling shareholder is found to have engaged in oppressive behavior after a trial.[23] Once invoked, the dispute, if any, will revolve around the price at which the controlling shareholder will buy the minority interest.[24] Without an admission of wrongdoing a controlling shareholder can eliminate the complaining shareholder and allow the corporation to focus on its principal function—business. However, the invocation of this remedy will depend largely on the price at which the controlling shareholder is ordered to purchase the minority interest. If a less expensive alternative that similarly eliminates the risk of dissolution is available, the controlling shareholder will likely pursue it.

iii. The Cash-Out Merger

A third possible course of action for a controlling shareholder faced with oppression litigation is to exercise his control to eliminate the minority shareholder in a cash-out merger.[25] Rather than defend

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22. *See, e.g.,* MODEL BUS. CORP. ACT § 14.34 (2002) (providing an election procedure); AZ. REV. STAT. ANN. § 10-1434 (2005) (same); MINN. STAT. ANN. § 302A.751 subd. 2 (West 2004) (same); N.D. CENT. CODE § 10-19.1-115 (2001) (same); N.J. STAT. ANN. § 14A:12-7(8) (West 2003) (same); N.Y. BUS. CORP. LAW §§ 1104-1, 1118 (McKinney 2003).

23. *See, e.g.,* MODEL BUS. CORP. ACT § 14.34(a)-(h) (2004) (providing for "fair value" once election is made and "[a]fter an election has been filed . . . the [oppression proceeding] may not be discontinued or settled, . . . unless the court determines it would be equitable to the *corporation and the shareholders*, *other than the petitioner*, to permit such discontinuance . . . .") (emphasis added).

24. *Id.*

25. One commentator describes the nature of a cash-out merger:

> Minority shareholders 'cashed out' by the majority are particularly vulnerable to coercion. In this type of fundamental corporate change, minority shareholders cannot choose between taking part in a new venture or receiving the fair value of

the involuntary dissolution act, or elect to buy-out the minority, a controlling shareholder with a sufficiently large majority position[26] can effect a merger of the corporate entity. A controlling shareholder can force the minority to take a cash price, set by the majority, for his interest in the corporation.[27] This effectively eliminates the risk of dissolution associated with an oppression action in the same way as an elected buy-out, with the added bonus that the majority is able to set an independent preliminary price.[28] A minority shareholder's only options will be either to litigate the fairness of the merger or to pursue an appraisal. In either case, dissolution is no longer a possible remedy. A minority shareholder who sought to liquidate his interest and exit the corporation is likely to perfect his appraisal rights to ensure he secures a fair price for his shares.[29] The benefits of effecting a cash-out merger rather than electing to buy-out the minority are explored further below.

corporation, whether due to oppressive behavior, an unfair merger, or questionable corporate decision-making, courts are called upon to sort out the grievances of the parties and determine an appropriate remedy.[31] The parties look to common law and legislative enactments providing causes of action in oppressive situations.[32] As discussed above, many jurisdictions provide for common law remedies in cases of shareholder oppression, whereas others have imbedded those remedies in comprehensive "involuntary dissolution" statutes.[33] Such statues commonly address several causes of action, of which oppression is the most relevant.[34] Another typical statute, commonly dubbed a "dissenter's rights" statute, provides a remedy for shareholders unhappy with a proposed merger.[3]

corporation does not have a readily available market for his shares.[38] At times, liquidating an interest in a close corporation can be nearly

The same is true of the elected buy-out described above.[49] When invoked, the parties are typically instructed to negotiate a price acceptable to both.[50] However, often times the parties are unable to agree upon a price. In such a case, the court sets a "fair value" for the interest in question.[51]

C. Fair Value in Dissenter's Rights (Appraisal) Statutes

Oppression is not the only behavior that sends aggrieved shareholders running to the courthouse. Judicial intervention is commonly sought when there is a merger of corporate entities. One of the powers of majority control is the ability to decide when, and if, one corporate entity will merge with another.[52] Most importantly, a controlling shareholder has the authority to set the price offered for the shares transferred.[53] Minority shareholders who dissent from a proposed merger are unable to prevent it. They do not have sufficient voting power to stop the merger even if they feel the price offered is unreasonably low. State legislatures have intervened to provide a remedy for a minority shareholder who dissents from a proposed merger. Pursuant to dissenter's rights (or appraisal) statutes, minority shareholders can dissent from certain listed corporate actions, including mergers, and ask the court to determine the value of their interests.[54] A dissenting shareholder must follow the procedures

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"[t]he purchase by the corporation or one or more shareholders of all the shares of one or more other shareholders for their *fair value*" as an alternative to dissolution (emphasis added)); MINN. STAT. ANN. § 302A.751 subd. 2 (West 2004) (calling for determination of "fair value" where buy-out is ordered).

49. *Id.*; *see also supra* Part 1.C.2 (discussing the elected buy-out).

50. *See, e.g.,* MINN. STAT. ANN. § 302A.751 subd. 2 (2004) ("If the parties are unable to agree on fair value within 40 days of entry of the order, the court shall determine the fair value of the shares . . . .").

51. *Id.*

52. *See, e.g.,* MODEL BUS. C..

specified in the governing statute to trigger an appraisal.[55] Once the requirements are met, if the parties cannot agree on a price, the court is once again directed to determine the "fair value" of the dissenting shareholder's shares.[56]

D. Is Fair Value Identical Regardless of the Context?

Although most jurisdictions have separate statutes governing involuntary dissolution and appraisal actions, both typically call for a "fair value" determination, or some other variant, as a remedy.[57] Because of the congruent language, courts called upon to determine the meaning of "fair value" in one context typically resort to case law interpreting the provision in the other context.[58] The prevalence of this practice may lead one to conclude that the particular statutory provision considered is not determinative. However, as discussed Dath(6)the

attached to "fair value" will have considerable consequences for all parties involved. However, what is "fair value"? When asked to determine the meaning of statutory language, courts initially seek guidance from the statute itself.[60] Despite its prevalent use in numerous dissolution and appraisal statutes, legislatures have often

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B. Fair Value is an Approximation of Fair Market Value

Not every court readily accepts the argument set forth above. The assertion that a legislature must have meant to distinguish "fair value" from "fair market value" is appealing. However, the distinction in language may have merely been a difference in style, rather than substance.[67] Indeed, one court attributed no meaning to the minor difference in terms.[68] In *Pohl v. Milsco Manufacturing Co.*,[69] a Milwaukee court attributed identical meanings to the terms.[70] The court explains:

> In cases where a ready market for shares exists, courts have used the term fair market value. Where no market exists, another valuation method is employed to determine the fair value of shares. Essentially, these values are the same, only determining fair value without the aid of a market place causes the court to adopt and recognize other methods of evaluation which are most equitable under the facts.[71]

Thus, when setting "fair value," the court should attempt to reach the price a willing buyer would pay a willing seller using the most equitable valuation method available. This contention carries greater force when we view it in light of appraisal statutes containing a "market exception" for stock listed on a public exchange, or in the hands of a set minimum number of shareholders.[72] In those statutes,

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> and elements which reasonably might enter into the fixing of value. Thus, market value, asset value, dividends, earning prospects, the nature of the enterprise and any other facts which were known or which could be ascertained as of the date of the merger and which throw any light on future prospects of the merged corporation are not only pertinent to an inquiry as to the value of the dissenting stockholders' interest, but must be considered by the agency fixing the value.

Tri-Continental, 74 A.2d at 72; *see also* Ex parte Baron Services, Inc., 874 So.2d 545, 550 (Ala. 2003) (citing Delaware cases for definition of fair value); Advanced Commc'n Design, Inc. v. Follett, 615 N.W.2d 285, 290 (Minn. 2000).

67. Emory, *supra* note 63, at 1171.

68. Pohl v. Milsco Mfg. Co., No. 89-CV-02091, slip op. (Wis. Cir. Ct., Milwaukee County Jul. 12, 1991).

69. *Id.*

70. *Id.* at 6.

71. *Id.*

72. *See, e.g.,* DEL. CODE ANN. tit. 8 § 262(b)(1) (2001) (providing that no appraisal

the "fair value" language is only operative where the shares in question are not listed on an exchange or where there are so few shareholders that a "fair market" simply does not exist.[73] Where it is effectively impossible to set a "fair market value," the court is instructed to do the next best thing: set a "fair value." Viewed in this way, "fair value" is merely a judicial fiction, an imaginary market

upon the specific circumstances of the sale of shares. The first two types of discounts are general and can arguably be applied in most valuation cases.[75] The two remaining discounts, although relatively established, rely heavily on fact-specific prerequisites to merit application.[76] Thus, the discussion below will focus on application of minority and marketability discounts.

A. Minority Discounts

A minority discount is applied to non-controlling, or minority, interests in a corporation to compensate for a lack of control over, and the inability to direct, corporate functions.[77] Minority interests, by their nature, lack sufficient voting power to independently control the functions of a corporate entity.[78] Due to their lack of control, holders of minority interests in close corporations face considerable challenges when they attempt to sell and exit the corporation.[79] Potential purchasers of minority interests may require a significant discount to compensate for the risks associated with lack of control.[80] Furthermore, several valuable aspects of control, absent from minority interests, are explored in detail below.

One may argue that lack of control, in and of itself, need not necessarily lead to a minority discount. Rather, the risks associated with that lack of control are the compelling force behind the application of a discount. First, a minority discount compensates for the possibility that a controlling shareholder will use his power to direct corporate functions in a way that expropriates value from a minority.[81]

75. *Id.*

76. *Id.*

77. *See, e.g.,* Columbia Mgmt. Co. v. Wyss, 765 P.2d 207, 213 (Or. Ct. App. 1988) (recognizing that the minority "discount recognizes that controlling shares are worth more in the market than are noncontrolling shares"); Wenzel v. Hopper & Galliher, P.C., 779 N.E.2d 30, 38 (Ind. Ct. App. 2002) ("A minority discount allows an appraiser to adjust for a lack of control over the corporation on the theory that minority shares are not worth the same amount to a third party as the majority holdings due to a lack of voting power.").

78. *Id.*

79. *Id.*

80. Anthony & Borass, *supra* note 74, at 1189 ("A minority discount can be substantial and often ranges from fifteen to thirty-five percent of value.").

81. *See* John C. Coates IV, *"Fair Value" As An Avoidable Rule of Corporate Law: Minority Discounts in Conflict Transactions*, 147 U. PA. L. REV. 1251, 1273-77 (1999) (discussing three distinct values associated with minority discounts when viewed as the converse of control premiums).

value.[89] Two assets may enjoy an increase in value when utilized in combination, rather than separately.[90] Likewise, two assets may have greater value when owned by one entity, rather than two separate entities.[91] This increase is known as "synergy value," because it is an increase in the value of each asset resulting from their interaction.[92] At times, corporations search for other entities to acquire in an effort to capture increased value that results from the interaction of their combined assets.[93] Theoretically, any captured synergy value would be shared proportionately among controlling and minority shareholders. However, a controlling shareholder may abuse his power and expropriate any captured synergies for himself. A minority discount compensates for the decreased likelihood that a minority shareholder will proportionately benefit from synergies. The control premium paid for a controlling interest that guarantees enjoyment of captured synergies is inversely related to the minority discount. Viewed in this way, a minority discount that compensates for the possibility of expropriation implicitly accounts for the risk that synergies will also be the target of expropriation.

Only controlling shareholders have the power to direct the use of corporate assets in order to seize synergistic opportunities.[94] Thus, pure control value is related to synergy value. Pure control is the residual value attached to the ability to control the operations of a particular business entity.[95] By definition, a controlling shareholder directs the functions of the corporation. Certain things inhere in control, such as the certainty of being able to seize discovered synergies, direct compensation and dividends, dissolve the entity, and to cash-out a minority shareholder in order to expropriate value.[96] Purchasers are willing to pay a premium for an interest that guarantees the exercise of such control.[97] Conversely, a potential purchaser of a minority interest would insist upon a discount to reflect his inability to exercise control.[98] Viewed in this way, values

89. Coates, *supra* note 81, at 1273-77.
90. *Id.*
91. *Id.*
92. *Id.*
93. *Id.*
94. *Id.*
95. *Id.*
96. *Id.*; *see also* Haynsworth, *supra* note 88, at 492-93.
97. Haynsworth, *supra* note 88, at 492-93.
98. *Id.*

associated with pure control are distinct from expropriation value. For example, even absent the possibility of expropriating wealth from a minority, purchasers would pay a premium for control simply to direct operations where they believe a new management strategy would create value. Conversely, absent the possibility of expropriation, a purchaser would still insist upon a discount to the value of a minority interest to reflect his inability to direct the management and operation of the corporation.

Simply stated, a minority discount is the difference between the value of controlling shares and the value of non-controlling shares in a corporation.[99] The discount reflects several aspects of control that are absent from a minority interest, just as a control premium reflects the presence of control. A purchaser of a minority interest would

public exchanges and do not enjoy the benefits of an active market.[104] Increased time and expense are required to liquidate such shares.[105] Lack of an organized market results in considerable difficulty selling close corporation interests. Thus, a potential purchaser of close corporation stock will assume he too would face difficulty if he later chose to liquidate his interest and will insist upon a discount to compensate for that fact.[106] Stated differently, a marketability discount accounts for the difference between the price an investor would pay for the shares in a close corporation and an identical interest in a public corporation.[107] The difference is related to the increased liquidity associated with public stock.

Investors attach great value to the increased liquidity of public stock.[108] Empirical data suggests that investors will pay an average of thirty-five to fifty percent more for an interest in an actively traded stock than a comparable interest without an active market.[109] Thus, the application of a marketability discount has a significant impact on the valuation of stock. Consequently, marketability discounts draw considerable attention during valuation and have been reviewed by numerous courts, with varying results.

V. HOW DO COURTS EVALUATE DISCOUNTS?

Once the relevant discounts are understood, the question remains whether they are appropriate in a given situation. To say that courts have disagreed on the subject is more than an understatement. Virtually every court that has addressed the issue has done so in a unique manner, taking account of unique considerations. Despite the wide variety of judicial approaches, it is possible to distill several common themes that appear throughout the case law. In general, courts take into account the following considerations: a) whether the "fair value" determination is made in the context of an appraisal or oppression case; b) the identity and position of the eventual owner of

104. *Donahue*, 328 N.E.2d at 514; *see also supra* note 1 (defining the close corporation).

105. *See supra* note 37 and accompanying text.

106. Moll, *supra* note 42, at 316-17 ("The marketability discount is premised on . . . [the] reality that investors will generally pay less for close corporation shares because of the shares' relative illiquidity.").

107. James H. Eggart, *Replacing the Sword with a Scalpel: The Case for a Bright-Line Rule Disallowing the Application of Lack of Marketability Discounts in Shareholder Oppression Cases*, 44 ARIZ. L. REV. 213, 220 (2002).

108. *See id.*

109. Emory, *supra* note 63, at 1161.

the valued shares; c) the need to punish oppressive behavior; d) whether the discount is applied at the shareholder or corporate level; e) the possibility that a buy-out transaction is an alternative to dissolution; and f) the compelled nature of the share transfer. No single consideration is overriding and courts have used a variety of combinations in their decisions.[110] The following discussion will expose the strengths and weaknesses of each consideration as they relate to the application of share price discounts. In particular, attention is paid to the appropriateness of each consideration as applied to an elected buy-out by a controlling shareholder.

A. Oppression v. Appraisal

When evaluating the appropriateness of discounts, a court may consider the statute invoked that led to a given "fair value" determination. Earlier in the discussion, we noted that most courts treat the discount issue similarly whether discussing "fair value" in the oppression context, under an involuntary dissolution statute, or the appraisal context, under a dissenter's rights statute.[111] However, at least one court has drawn a distinction between oppression and appraisal disputes.[112]

In *Charland v. Country View Golf Club*,[113] the Supreme Court of Rhode Island addressed the applicability of minority and marketability discounts under the state's involuntary dissolution statute.[114] In *Charland*, a minority shareholder in a close corporation petitioned for dissolution, claiming that corporate officers had

shares.[117] As often occurs, the parties could not agree and asked the court to set a "fair value."[118] After appointing a first and second appraiser, the lower court rejected the application of both minority and marketability discounts.[119] Upon review, the Supreme Court affirmed the denial of share-price discounts, holding that both were inapplicable where the majority elects to buy-out a minority shareholder at the outset of an oppression dispute.[120]

The court was very careful to limit its holding to the precise context of the case: an elected buy-out pursuant to an involuntary dissolution statute.[121] Relying heavily on *Brown v. Allied Corrugated Box Co.*, and the identity of the purchaser rationale,[122] the court quickly rejected the application of the minority discount in this context, stating: "When a corporation elects to buy out the shares of a dissenting shareholder, the fact that the shares are noncontrolling is irrelevant."[123] The court also rejected the marketability discount, relying on minor, but "significant," distinctions in the language of the Rhode Island statute as compared to the New York statute (under which the discount had been sanctioned).[124]

The key aspect of the decision is the distinction the court draws between an election to buy-out and an appraisal action. After limiting its question to "whether to apply a minority discount in a situation in which a corporation elects to buy out a shareholder who has filed for dissolution,"[125]

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i. Purchase by Controlling Shareholder or Corporation

In the typical case, the oppressed party seeks judicial intervention to value his shares in order to liquidate his investment in the close corporation. The oppressed party invokes the involuntary dissolution statute available in his particular jurisdiction. Rather than dissolve the company, the court often orders the controlling shareholders to buy out the oppressed minority at "fair value."[139] Alternatively, the controlling shareholder may elect to buy the minority shares prior to litigation of the oppression claim. Thus, the controlling shareholder will purchase the shares from the minority and further consolidate control over corporate operations.

Courts emphasize that minority discounts account for the lack of control associated with a shareholder's minority status.[140] However, when the majority purchases the shares, the shares are no longer "minority" shares, they become part of the controlling block of shares previously used to oppress the minority.[141] In the hands of a controlling shareholder, the shares are worth more than the same shares in the hands of any other party, especially the former minority shareholder.[142] Therefore, the minority discount is not appropriate where the majority is ordered to purchase the minority's shares.[143]

In *Wenzel v. Hopper & Galliher, P.C.*, [144] the Indiana Court of Appeals rejected the application of minority discounts where the stock was to be purchased in a buy-back transaction by either the controlling shareholder or the corporation itself.[145] While determining "fair value" during an appraisal under Indiana's professional corporations statute, the court focused on the identity of the purchasing party while evaluating the appropriateness of share-price discounts.[146]1 4 6 146

> The sale differs from a sale to a third party and, thus, different interests must be recognized. When selling to a third party, the value of the shares is either the same or less than it was in the hands of the transferor because the third party gains no right to control or manage the corporation. However, a sale to a majority shareholder or to the corporation simply consolidates or increases the interest of those already in control. Therefore, requiring the application of a minority discount when selling to an "insider" would result in a windfall to the transferee.[147]

The "windfall" would be the opportunity to pay a discounted price for shares that are actually worth an undiscounted value in the hands of the majority. Although logically sound, the permeability of the argument is exposed after scrutiny. As the court notes, a sale to the controlling shareholder merely "increases" the interest of those in control.[148] As one early court noted, "there are 51 shares . . . that are worth $250,000 . . . . [and] [t]here are 49 shares that are not worth a [damn]."[149] Where a party is already in control of a corporation, merely increasing his interest from 51% to 75% or 90% has little effect on his ability to dictate the functions of the corporation. Excepting certain mergers or consolidation transactions,[150] holding an interest over 51% typically carries little additional authority. A 51% controlling shareholder can expropriate value using almost every method at the disposal of a 90% owner. A court should not assume that the additional shares impart any greater level of control as a basis to reject the application of a minority discount. Therefore, the minority discount, which accounts for the lack of control, should apply to the shares regardless of the eventual purchaser. A third-party would not have control and the controlling shareholder already does.[151]

In *Brown v. Allied Corrugated Box Co.*,[152] a group of minority shareholders in a closely held corporation petitioned for involuntary

147. *Id.* at 39 (citing *Hansen v. 75 Ranch Co.*, 957 P.2d 32, 41 (Mont. 1998)).

148. *Id.* (quoting *Hansen*, 957 P.2d at 41 ("a sale to the majority . . . simply consolidates or increases the interest of those already in control")).

149. Humphrys v. Winous Co., 133 N.E.2d 780, 783 (Ohio 1956).

150. For example, to effect a merger without shareholder or board approval, a controlling shareholder may be required to have a supermajority interest (i.e. 90% of voting

minority, or oppressed, shareholder. However, in *Balsamides v. Protameen Chemicals., Inc.*,[159] the Supreme Court of New Jersey affirmed an order that the *oppressor* sell his shares to the party initially seeking dissolution.[160] Most importantly, the court upheld the application of a marketability discount where the oppressed party is the purchaser.[161]

In *Balsamides*, the close corporation was owned by two parties with equal 50% interests in the company.[162] The complaining party petitioned for dissolution claiming oppression by his business partner under a breach of fiduciary duty theory.[163] The trial court, acting under authority of the New Jersey involuntary dissolution statute, ordered a buy-out in lieu of the sought after dissolution.[164] Surprisingly, the *oppressed* party was ordered to buy-out his partner for "fair value."[165159]

35% discount for marketability was applied in order to spread the burden of illiquidity, inherent in close corporations, between the two parties.[171] If the oppressor is not required to sell his shares at a price that reflects the company's lack of marketability, the oppressed party "will suffer the full effect of [the company's] lack of marketability at the time he sells."[172] The court held that "in deciding whether to apply a marketability discount to determine the 'fair value' of shares of a shareholder forced to sell his stock in a judicially ordered buy-out [courts] must take into account what is fair and equitable."[173] To secure a "fair value" for the oppressor's stock, "a marketability discount should be applied. To do otherwise would be unfair, particularly since [the purchasing party] was the oppressed shareholder."[174]

The argument advanced by the *Balsamides* court strikes more deeply than the court intended. By focusing on the equities, the court ignores the economic realities for which the marketability discount compensates. Regardless of which party purchases the other's interest, the purchasing party will be faced with a difficult task in later liquidating his interest in the close corporation. For exampl554 -1 assu.00rkecount

C. Penalizing the "Wrongdoer"

Some courts have rejected discounts based on the actions of the parties that lead to the valuation proceeding. Courts regularly assert that discounts are inappropriate because a controlling shareholder acted oppressively. Rejecting discounts punishes the controlling shareholder for improper behavior by increasing the price at which the controlling shareholder must purchase the minority interest.

For example, in *Chiles v. Robertson*, the court found a breach of fiduciary duties and oppressive conduct,[176] and proceeded to determine the "fair value" of the minority shares in question.[177] The Oregon Court of Appeals affirmed the trial court's refusal to adjust the purchase price to reflect minority and marketability discounts.[178] The court emphasized that the purchase was a judicial remedy for the defendants' wrongdoing and that "[t]his is not a sale by a willing seller to a willing buyer, and defendants should not benefit from reductions in value that are based on such a sale."[179] The *Chiles* court then observes that in *Columbia Management v. Wyss*,[180] an Oregon court applied a 33% discount "when there was no evidence of misconduct."[181] The only aspect of the *Columbia Management* opinion worth noting is the court's remark about the use of discounts when oppression is present:

> Nothing in either the appraisers' recommendations or in our decision is based on a conclusion that Columbia's action was improper. The appraisers specifically noted that fair market value might not be the appropriate measure of fair value in a squeeze out or other oppressive situation, but they found that no such circumstance existed in this case.[182]

This is damaging for a party hoping to receive discounts in an oppression case, but was not a binding statement of law. Moreover, the *Columbia* court followed the above statement by noting that its "decision not to apply a minority discount . . . is not based on any

176. 767 P.2d 903, 923 (Or. Ct. App. 1989) ("Our finding that defendants breached their fiduciary duties is, in these circumstances, also a finding that they engaged in oppressive conduct toward plaintiffs that would justify dissolution under ORS 57.595(1)(a)(B).").

177. *Id*. at 924-25.

178. *Id.* at 926.

179. *Id.*

180. 765 P.2d 207 (Or. Ct. App. 1988).

181. *Chiles*, 767 P.2d at 926 (citing *Columbia Management*,765 P.2d at 213).

182. *Columbia*, 765 P.2d at 215.

determination that Columbia acted improperly."[183] This left room for speculation as to whether misconduct would be grounds on its own for a denial of minority discounts, or all discounts. The *Chiles* court closed what the *Columbia Management* court left open. In *Chiles*, the court concluded that, in the context of oppression, discounts are inappropriate: "In addition, applying [marketability and minority] discounts would give plaintiffs less than they would receive on a dissolution . . . a result that would not be appropriate in light of our finding of defendants' oppressive conduct."[184] Thus, according to the *Chiles* court, discounts are not appropriate when a controlling shareholder is found to have engaged in oppressive conduct.

Likewise, the *Balsamides* court focused on the wrongdoing of the oppressive party while evaluating the appropriateness of discounts.[185] There, the court applied a marketability discount to the shares of the oppressor, a peculiar situation as noted above.[186] In doing so, the court noted the absence of an established market for the shares and the inherent illiquidity of close corporation stock.[187] However, the language of the decision suggests the court also attributed significance to identifying one party as the wrongdoer.[188] The court regards failure to apply a discount as "unfair, particularly since [the selling party] was the oppressor and [the purchasing party]

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183. *Id.*

184. *Chiles*, 767 P.2d at 926.

185. *Balsamides*, 734 A.2d at 724-25 (affirming trial court decision based, in part, on a belief that one party was "more at fault").

186. *Id*. (ordering oppressor [Perle] to sell his shares to the oppressed [Balsamides]); *see also supra* Part V.B.2 for further discussion of the factual background.

187. As the New Jersey Supreme Court stated:

> . . . The position of the Appellate Division ignores the reality that Balsamides is buying a company that will remain illiquid because it is not publicly traded and public information about it is not widely disseminated. [The company] will continue to have a small base of available purchasers. If it is resold in the future, Balsamides will receive a lower purchase price because of the company's closely-held nature.
>
> . . . [I]f Perle is not required to sell his shares at a price that reflects [the company's] lack of marketability, Balsamides will suffer the full effect of [the company's] lack of marketability at the time he sells. Accordingly, we find that Balsamides should not bear the brunt of [the company's] illiquidity merely because he is the designated buyer.
>
> . . . The fact that the buyer is known is irrelevant. When Balsamides eventually sells, he will suffer the full effect of any marketing difficulties.

Id. at 735-36; *cf. id*. at 737 (noting expert testimony indicating that even 100% interests in close corporations should be discounted for lack of marketability).

188. *Id.* at 735-36.

was the oppressed shareholder."[189]

By focusing on the wrongdoing of one party, both the *Chiles* and *Balsamides*

"fair value" be fixed as a pro rata share of the firm without reference to the particular shares.[199] Doing so excludes consideration of the controlling, or noncontrolling, nature of the shares at issue. However, if the pro rata value doctrine requires only that no discount be imposed at the shareholder level, while permitting discounts at the corporate level, controlling shareholders need only discount the corporate level valuation total to avoid rejection. That is precisely what was done in *Tri-Continental*, where the court sustained a discount.[200]

While rejecting the application of discounts to a dissenting shareholders stock, the *Cavalier* court distinguished *Tri-Continental*. In *Tri-Continental*, the appraised company was a leveraged, closed-end investment company. Therefore, the court noted, the shareholders had no right to demand their pro rata interest at any time. In essence, the shares in the corporation lacked marketability. This, coupled with the company's leveraged position, would result in a lower market value for its stock than its net assets represented:

"going concern."[201]

By distinguishing a corporate-level discount from a shareholder-level discount as a basis for rejecting its application in a particular case, the court fails to recognize their identical effects. For example, suppose a controlling shareholder is forced to purchase an oppressed minority's shares. During valuation of the business, an appraiser adjusts the total value of the company to reflect the fact that it is a close corporation with no established market for its stock. The *Cavalier* court would accept this discount as a corporate-level discount, because it applies to every share of the company equally.[202] However, because the minority's shares are also included in this initial valuation, his proportionate interest will reflect the lack of marketability of every share in the corporation. On the other hand, had the appraiser valued the entire business without accounting for its closely held status, the value of each share would not reflect a discount. If the minority shares were then separately adjusted to account for illiquidity, for example, the *Cavalier* court would reject the adjustment as one at the shareholder-level.[203] Yet, regardless of the level at which the discount is applied, the dissenting or oppressed shareholder will receive the same value for his interest.[204] At both levels, the discounts account for the same economic realities; the difference is only in the timing of application.

E. Buy-out as Alternative to Dissolution

Great emphasis has been placed on the notion that a buy-out—court-ordered or elected—is essentially an alternative to an involuntary dissolution. Many courts, while rejecting the application of discounts, focus on the alternative nature of the buy-out remedy.[205] Because the complaining party initiated the action seeking dissolution, some courts approximate "fair value" as the value the

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201. *Cavalier Oil*, 564 A.2d at 1145.

202. *See id.* at 1144-45.

203. *See id*.

204. For example, assume that a close corporation has an undiscounted value of $1000. There are two shareholders: one with 90 shares, the other with 10. If the court applies a 40% discount as the corporate level then: $1000 discounted 40% = $600; $600 divided by a total of 100 shares = $6 per share; a minority with 10 shares would receive $60. Compare the following application of the 40% discount at the shareholder level: $1000 divided by 100 shares = $10 per share; $10 per share discounted 40% = $6 per share; a minority with 10 shares would receive $60 for his interest.

205. *See, e.g., Charland*, 588 A.2d at 612; *Brown*, 154 Cal. Rptr. at 176.

rejected the application of a marketability discount while determining "fair value" pursuant to a dissenter's rights statute.[227] Citing *Cavalier Oil*, the Alabama court notes that "the appraisal process is not intended to construct a *pro forma* sale, but to *assume that the shareholder was willing to maintain his investment position, however slight, had the merger not occurred*."[228] This is so because a minority shareholder must have dissented to the merger proposal in order to reach the appraisal stage.[229] Dissent indicates a willingness to retain one's interest in the corporation. Thus, the minority was not a willing seller, but rather compelled to sell his interest against his will. In this way, an appraisal does not equate to sale for fair market value, which requires a willing seller and a willing buyer.[230] Because the marketability discount is intended to adjust the share price to approximate the difficulties a willing seller would face on the open market, its application is inappropriate where a sale is compelled.

However sound in the appraisal context, the compulsion argument does not apply equally to actions for involuntary dissolution, whether or not they result in a buy-out. When a minority shareholder petitions for the dissolution of a corporation, inherent in the decision is a desire to end his investment in the corporation. If he is successful in dissolving the company his shares will be exchanged for their proportionate value of the proceeds of the dissolution sale, he will no longer have an investment in a corporation. Moreover, the minority seeks to dissolve the company entirely, ending its ability to operate as a going-concern. Therefore, assuming that the minority sought to maintain his interest as a grounds for rejecting the marketability discounts is untenable in the dissolution context. If the company is dissolved 4]TJT*6.5(a)0.6(0s,)]TJT(was no2eo)6.5(a)TJT*2 Tc0.3xoluti[ority21g0
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> One leading Oregon practitioner opines that the election is unlikely to be exercised, because it guarantees the outcome that, from the perspective of the majority, is the least desirable—a purchase at a price determined by a court without discount for marketability or minority. A course preferable to the majority might be to freeze out the minority by a reverse stock split or other device [e.g., a cash-out merger], which would also entail payment for the stock but with a minority discount.[233]

This position emphasizes the ability of the controlling shareholder to set the terms of a merger transaction, most importantly the price, rather than await "a purchase price determined by a court."[234] The controlling shareholder is free to take into account the nature of the business, its relative marketability, and the lack of control inherent in minority stock while setting the price at which the merger, or reverse split, will occur. The ability to do so inheres in the controlling shareholders domination of corporate decision-making. spectki.8(.[(se pr5.8(.[(sh t9s

eliminate the uncertainty of an oppression claim, set a starting point for the ensuing "fair value" determination, and limit the minority's recourse to appraisal.

Even if the price is successfully challenged, "fair value" at appraisal will be no greater than it would have been had a court set the price after a controlling shareholder elected a buy-out. In addition, testimony regarding the oppressive actions of one party is not relevant to an appraisal action, which is limited to the issue of price.[238] Unlike the oppression context, and its related elected buy-out, no finding or implication of wrongdoing should be considered during an appraisal. A party must often challenge the entire merger in a separate action in order to bring those issues into consideration, thus increasing litigation costs and risk.[239] Cashing-out a minority can provide a controlling shareholder a strategic advantage not available where he elects to buy-out the minority under a dissolution statute.

B. Reasons to Apply Discounts when an Election to Buy-Out is Invoked

Section 5 addressed the common arguments advanced against the application of share-price discounts in various contexts. It is clear that most courts treat the discount issue similarly in every context: oppression, election, and appraisal.[240] However, many arguments advanced against discounts in oppression and appraisal cases are particularly weak when applied to an elected buy-out by a controlling shareholder.

The punishment rationale should not be applied in election cases because there is no finding of wrongdoing; allegations of wrongdoing

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> allegations that permit any inference of self-dealing, fraud, deliberate waste of corporate assets, misrepresentation, or other unlawful conduct, the remedy afforded by [the dissenter's rights provisions] is exclusive. That is true even if the majority shareholders acted arbitrarily or vexatiously or not in good faith.

Stringer v. Car Data Systems, Inc., 841 P.2d 1183, 1190 (1992).

238. *See, e.g., Cavalier Oil*, 564 A.2d at 1142-43 (citing *Cede & Co. v. Technicolor Inc.*,

are only available at the time of election.[241] The dissolution analogy is inappropriate, because where an election is available it should be viewed as a viable alternative remedy on its own, rather than a substitute for dissolution.[242] Furthermore, the compelled sale argument is rather weak where an election is made, because the party seeking dissolution hoped to end his investment in the entity prior to the purchase by the majority party.[243] Other arguments are equally weak in all three contexts.[244]