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Ruling goes against minority shareholder on costs

By Matthew J. O'Hara

While disputes among owners of closely held entities are common, and those disputes inevitably involve business valuation, published court decisions applying statutory valuation standards are few and far between. Recently, the 2d District Appellate Court published a thorough opinion on the concept of "fair value" under the dissenters' rights appraisal statute in the Illinois Business Corporation Act. In *Brynwood Company v. Schweisberger* (No. 2-06-1178, July 23), the court reversed a finding after a bench trial that costs related to the sale of the corporation's only asset should not be included in appraising the fair value of the dissenting shareholder's shares. The court rejected the shareholder's argument that charging him for the transaction costs was an erroneous application of a "fair market value" rather than the statutory "fair value" standard. The court also rejected his argument that because the "fair value" concept requires using a business's going concern value, his shares should not be charged with expenses incurred after the valuation date. This decision may wear away some of the value in the "fair value" concept for dissenting shareholders, though it remains to be seen to what degree.

"Fair value" and "fair market value" are distinctly different concepts. Fair market value is "the price that would be agreed upon in an arm's-length transaction between a willing buyer and a willing seller on the open market, neither under a compulsion to act, and both parties possessed of all relevant facts." *Institutional Equip. & Interiors, Inc. v. Hughes,* 204 Ill.App.3d 922, 930 (2d Dist. 1990). In contrast, the appraisal statute for dissenting shareholders, as well as the statute providing for judicially imposed remedies in cases of shareholder deadlock, oppression, or waste and abuse of corporate assets, both mandate the use of "fair value." See 805 ILCS 5/11.70(c) (dissenters' rights); 805 ILCS 5/12.56 (shareholder remedies). These provisions are based on the Model Business Corporation Act and similar ones exist in many other states. The fair value standard asks what the value of the business is as a whole, typically as a going concern, and then applies a shareholder's percentage stake to that amount to determine the amount due. *See* 805 ILCS 5/11.70(j)(1); 805 ILCS 5/12.56(e)(v); *Pueblo Bancorporation v. Lindoe, Inc.,* 63 P.3d 353, 356 (Colo. 2003).

In a more complex company, with many assets and corresponding operations and customers, transaction costs are far less ascertainable and more nuanced.

In *Brynwood*, the corporation only had one asset: a commercial building. The majority of the shareholders determined to sell the building and then dissolve the corporation. Schweisberger, a minority shareholder, dissented and demanded that he be paid the fair value of his shares. When the company sold its building, its capital gain was reduced by income taxes (it was a C corporation) as well as attorneys' and accountants' fees.

After a bench trial on valuation, the trial court determined that Schweisberger's shares should be exempted from the taxes and fees associated with the sale to determine fair value. The court accepted the premise that Brynwood Company was a going concern, and adopted the day before the sale as the valuation date.

Notably, the Appellate Court reversed under a highly deferential "manfest weight of the evidence" standard. Typically, reviewing courts have paid deference to trial court findings concerning valuation. See, e.g., *Stanton v. Republic Bank of South Chicago,* 144 Ill.2d 472, 480 (1991); *Jahn v. Kinderman,* 351 Ill.App.3d 15, 26-28 (1st Dist. 2004). To reverse under this standard, the *Brynwood* court was required to find that "all reasonable people would find the opposite conclusion to be clearly evident."

The Appellate Court found precisely that, adopting Brynwood Company's argument that exempting the transaction costs from fair value was "an inequitable transfer of wealth from the majority to the minority contrary to the purpose of the [Business Corporation] Act. . . ." As the court explained, "*Brynwood* urges that the trial court's construction of fair value would encourage shareholders of a corporation to dissent and '[r]ather than protecting minority shareholders from oppression, *** [would] foster and promote the veritable gamesmanship and corporate gridlock that the statute was enacted to remedy."

Schweisberger's argument was a logical one: the transaction costs were not incurred as of the valuation date, and therefore should not be considered when determining fair value of the corporation as a going concern. Including such costs, he argued, would be tantamount to fair market value rather than fair value.

The Appellate Court premised its holding on the concept that it was inequitable for the shareholder to receive his proportion of the gross proceeds when the costs were required to monetize the corporation's only asset. ". . . [A] proper calculation of the true, intrinsic value of the shareholder's percentage ownership should have necessarily taken into account all of the previously detailed foreseeable and ascertainable transactional costs that were known and inherent in the unique nature of Brynwood and its business as a closely held C corporation whose business was to hold a single parcel of real estate for its appreciated value." The transaction costs were part of the inherent nature of Schweisberger's investment, "because the fair market value of the building could not have been realized without also incurring the transaction costs. . . ." The court quickly dispatched Schweisberger's argument about the transaction costs not having been incurred as of

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the valuation date, finding that those costs were known or knowable as of the valuation date, and pertinent to the corporation's intrinsic value.

Finally, the court rejected the shareholder's argument that including the transaction costs would be tantamount to applying the "fair market value" standard. "Discounts at the shareholder level are generally disallowed because they result in undervaluing the dissenters' shares while overvaluing the majority's shares. . . . [T]he deduction that must be taken in the present case is at the corporate level and properly measures the true, intrinsic value of all the shares in the corporation . . . as a going concern immediately before the closing on the sale of the building."

The *Brynwood* court emphasized that its opinion should be seen as limited to its particular facts. The key facts are (1) that it is a dissenters' rights case, and (2) the corporation only had one asset, requiring transaction costs to turn that asset into cash for the benefit of all shareholders.

That *Brynwood* involved a dissenter's demand for an appraisal should limit the reach of its analysis in the context of the other statutory scenario for fair value, i.e., shareholder deadlock or oppression. The court emphasized there had been no oppression or self-dealing and that Schweisberger did not need to be protected from the majority. In addition, in the deadlock or oppression context, there will typically not have been a sale of the entire business in which the costs are known or ascertainable. Instead, the court will have to determine fair value in a transaction to take place in the future in which some shareholders or the corporation will buy out a minority shareholder. See 805 ILCS 5/12.56(b)(11). Creative counsel may argue, or wish to present testimony, that the costs of such a transaction are also ascertainable in advance. The barrier, however, is that such costs are not inherent in the process of monetizing the company's value to all shareholders.

That *Brynwood* involved a single-asset corporation may also limit its reach. Effectively, a single real estate transaction stood between Brynwood's shareholders and the cashing out of their investment. In a more complex company, with many assets and corresponding operations and customers, transaction costs are far less ascertainable and more nuanced. In the extreme case of a corporate dissolution imposed as a remedy for deadlock or oppression, see 805 ILCS 5/12.56(f)(12), however, it may be argued that the cost of monetizing all of a company's assets should be borne at the shareholder level. But court-ordered dissolution is a rare result indeed.

While *Brynwood* is based upon these key facts, it nevertheless provides a vehicle for stockholders who will be the buyers in a transaction that resolves a dispute among the owners of a closely-held business to argue that fair value should be reduced. To what extent the courts will agree, and whether it affects the settlement value of cases, remains to be played out.

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