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

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WILLAMETTE LAW REVIEW

INTRODUCTION

The focus of this paper is to evaluate the likelihood that a controlling shareholder, when faced with litigation, will invoke an election to buy-out the minority interests rather than pursue a cash-out merger. Because the risks associated with each option are similar, the selection will depend largely on the price at which the controlling shareholder is able to eliminate the complainants. Therefore, the following discussion focuses on the considerations that control the price at which the majority can lawfully eliminate the minority. Specifically, whether the legal standard controlling the price, “fair price” or “fair value,” includes discounts for the lack of marketability and lack of control associated with minority interests in close corporations. As explained below, these discounts can have a considerable impact on the price paid for minority interests. Their application or rejection in a given context can significantly affect a controlling shareholder’s course of action when faced with oppression litigation.

Section 1 introduces shareholder oppression and each party’s available courses of action during an oppressive situation. Section 2
discusses the relevance of “fair value” in the oppression context, while Section 3 addresses the meaning of “fair value” generally. Thereafter, Section 4 focuses on share-price discounts generally, explaining their purpose and conceptual underpinnings. Section 5 considers the various methods courts employ to evaluate the appropriateness of share-price discounts in a variety of situations. Finally, Section 6 closes the paper with a proposal for applying share-price discounts as a method of encouraging controlling shareholders to elect a buy-out where available.

I. SHAREHOLDER OPPRESSION

A. The Close Corporation

The most relevant characteristics of close corporations are their relatively small number of shareholders, the lack of an established market for stock, and substantial shareholder participation in the management and operations of the enterprise. In combination, these characteristics often result in conflict among the shareholders of the corporation. A common reaction to conflict is for the controlling, or majority, shareholder(s) to use their control over the corporation to the detriment of the minority shareholder(s).

Shareholders in public corporations are typically passive investors, contributing no labor and taking no part in the management of the corporation. Close corporation investors, however, usually invest with the expectation of gainful employment and participation in management, along with a return on their initial capital investment. Additionally, close corporations typically center around familial and personal relationships. This aspect further intensifies

1. BLACK'S LAW DICTIONARY 341 (7th ed. 1999) (defining close corporation as “[a] corporation whose stock is not freely traded and is held by only a few shareholders [often within the same family]”); see also Donahue v. Rodd Electrotype Co., 328 N.E.2d 505, 511 (Mass. 1975) (describing close corporations); Galler v. Galler, 203 N.E.2d 577, 583 (Ill. 1964) (explaining that in close corporations “stock is held in a few hands, or in a few families and . . . rarely dealt in buying or selling”).

2. 1 F. HODGE O'NEAL & ROBERT B. THOMPSON, O'NEAL'S CLOSE CORPORATIONS § 1.08, at 1-31 to 1-32 (3d ed. 2002) (describing the passive nature of investment in public corporation stock).

3. Robert B. Thompson, The Shareholder's Cause of Action for Oppression, 48 BUS. LAW. 699, 702 (1993); see also Pedro v. Pedro, 463 N.W.2d 285, 289 (Minn. Ct. App. 1990) (noting that “the primary expectations of minority shareholders include an active voice in management of the corporation and input as an employee”).

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

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5. See 1 F. HodGE O'NEAL & ROBERT B. THOMPSON, O'NEAL'S OPPRESSION OF MINORITY SHAREHOLDERS § 3:02 (2d ed. 1995) (describing techniques to oppress minority shareholders).

6. Donahue, 328 N.E.2d at 514 (“In a large public corporation, the oppressed or dissident minority stockholder could sell his stock in order to extricate some of his invested capital. By definition, this market is not available for shares in the close corporation.”).

7. Id.

8. Id.

9. See infra notes 37-38 and accompanying text (noting difficulties involved with liquidating close corporation shares as compared to shares in public corporations).
states have included oppressive behavior as grounds for seeking dissolution of a corporation under an involuntary dissolution statute.\textsuperscript{10} Despite the statutes’ names, dissolution is only one of a variety of remedies at a court’s disposal.\textsuperscript{11} Both courts and legislatures have fashioned less drastic remedies, the most common of which is the buy-out.\textsuperscript{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

\textsuperscript{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”).

\textsuperscript{11} Id. (providing twelve alternatives to dissolution).

\textsuperscript{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 majority and minority, until differences are resolved or ‘oppressive' conduct ceases;

(c) The appointment of a ‘special fiscal agent' to report to the court relating to the continued operation of the corporation, as a protection to its minority stockholders, and the retention of jurisdiction of the case by the court for that purpose;

(d) The retention of jurisdiction of the case by the court for the protection of the minority stockholders without appointment of a receiver or ‘special fiscal agent’;

(e) The ordering of an accounting by the majority in control of the corporation for funds alleged to have been misappropriated;

(f) The issuance of an injunction to prohibit continuing acts of ‘oppressive' conduct and which may include the reduction of salaries or bonus payments found to be unjustified or excessive;

(g) The ordering of affirmative relief by the required declaration of a dividend or a reduction and distribution of capital;

(h) The ordering of affirmative relief by the entry of an order requiring the corporation or a majority of its stockholders to purchase the stock of the minority stockholders at a price to be determined according to a specified formula or at a price determined by the court to be a fair and reasonable price;

(i) The ordering of affirmative relief by the entry of an order permitting minority stockholders to purchase additional stock under conditions specified by the court;

(j) An award of damages to minority stockholders as compensation for any injury suffered by them as the result of ‘oppressive' conduct by the majority in control of the corporation.

Baker v. Commercial Body Builders, Inc., 507 P.2d 387, 395-96 (Or. 1973) (citations omitted); see also Brenner v. Berkowitz, 634 A.2d 1019, 1033 (N.J. 1993) (“Importantly, courts are not limited to the statutory remedies, but have a wide array of equitable remedies available to them.”)
actions for oppression.\textsuperscript{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.\textsuperscript{14} The Massachusetts Supreme Judicial Court describes its fiduciary duty standard in \textit{Donahue v. Rodd Electrototype Co.}.\textsuperscript{15}

[\textit{W}e hold that stockholders in the close corporation owe one another substantially the same fiduciary duty in the operation of the enterprise that partners owe to one another. In our previous decisions, we have defined the standard of duty owed by partners to one another as the “utmost good faith and loyalty.” Stockholders in close corporations must discharge their management and stockholder responsibilities in conformity with this strict good faith standard. They may not act out of avarice, expediency or self-interest in derogation of their duty of loyalty to other stockholders and to the corporation.\textsuperscript{16}]

Many other courts have imposed like duties on controlling shareholders of close corporations.\textsuperscript{17} Both judicial and legislative responses address the same concern for minority shareholders. The two schemes are so similar one author propounds that “it makes sense to think of them as two manifestations of a minority shareholder’s cause of action for oppression.”\textsuperscript{18}

\textbf{C. Reaction of the Controlling Shareholder}

All too often, a controlling shareholder finds his behavior the subject of an oppression action. Faced with litigation, a controlling shareholder will most likely consider the benefits of available courses before taking action. When faced with a possible dissolution action, a controlling shareholder commonly has three available options: 1) litigate the dissolution action; 2) where available, invoke the election to buy-out; and 3) merge the corporation, forcing the minority shareholder to take cash for his interest. The controlling shareholder’s selection will largely depend on the risks of each course.

\begin{itemize}
\item \textsuperscript{13} See, e.g., \textit{Donahue}, 328 N.E.2d at 515.
\item \textsuperscript{14} \textit{Id.}
\item \textsuperscript{15} \textit{Id.} at 505.
\item \textsuperscript{16} \textit{Id.} at 515.
\item \textsuperscript{18} Thompson, \textit{supra} note 3, at 700.
\end{itemize}
of action. The potential monetary liability of the corporation will likely be of particular importance and its limitation may be a primary concern while selecting a course of action.

i. Action for Involuntary Dissolution

When a shareholder is faced with an oppression action, the most obvious response is to take the minority shareholder to task and defend the oppression claim on the merits. However, the risks involved with a dissolution action make this option all too risky for a conservative investor. First, the possibility that the corporate entity will be dissolved, however slim, weighs heavily against litigating the claim. Despite the trend toward preferring buy-out remedies over dissolution, dissolution is still within the realm of possible outcomes and cannot be excluded while evaluating the risk of litigation. In almost every case, a corporation is worth more to its owners when operating than if it were dissolved and sold to a third-party.19

Additionally, litigating an oppression action, particularly in the close corporation context, can be a complicated endeavor without regard to potential liability.20 As explained above, investors in close corporations typically work in direct contact, sharing familial or personal relationships along with business ties.21 These close relationships add to the tension and emotion inherent in litigation. A controlling shareholder may prefer a method of resolution that avoids conflict or, at the very least, limits it.

However, along with litigation comes the possibility of vindication. A controlling shareholder accused of oppressive behavior can defend the oppression action, keep the corporation intact and operating, and clear his name. However, once such an action is pursued, relationships may have already broken and the possibility of reconciliation among the majority and minority interest holders may be extremely limited.

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19. See, e.g., Balsamides v. Protameen Chems., Inc., 734 A.2d 721, 724 (N.J. 1999) (noting that where a trial court “considered the alternatives to a forced buy-out . . . [i]t rejected the idea of dissolving the corporation and selling its assets, concluding that a Company is worth significantly more as a going concern”).


21. See supra note 1 and accompanying text.
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.  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. Once invoked, the dispute, if any, will revolve around the price at which the controlling shareholder will buy the minority interest. 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. 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 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. 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. 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. The benefits of effecting a cash-out merger rather than electing to buy-out the minority are explored further below. We now turn to the legal standard that controls the price at which a controlling shareholder will be able to purchase a minority shareholder’s interest: “fair value.”

II. WHEN IS FAIR VALUE RELEVANT?

When a dispute arises between two more shareholders in a

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26. See, e.g., MODEL BUS. CORP. ACT §11.04 (c) (2002) (“approval of the plan of merger or share exchange requires approval of the shareholders at a meeting at which a quorum consisting of at least a majority of the votes entitled to be cast on the plan exists’’); DEL. CODE ANN. GEN. CORP. LAW tit. 8, § 251(c) (2001) (“If a majority of the outstanding stock of the corporation entitled to vote thereon shall be voted for the adoption of the [merger] agreement’’); see also MODEL BUS. CORP. ACT § 11.05 (2002) (providing that a controlling shareholder with a 90% interest in a subsidiary corporation may effect a merger without approval of the board or shareholders).

27. MODEL BUS. CORP. ACT § 11.05 (2002).

28. Id.

29. Typically a dissenting minority shareholder must (1) give advance notice that he intends to dissent from the merger plan, (2) refrain from voting for the merger plan to which he objects, and (3) demand payment and tender his shares to the corporation. MODEL BUS. CORP. ACT §§ 13.21-13.23. Furthermore, “once a shareholder deposits” his shares with the corporation, he “loses all rights as a shareholder.” Id. at § 13.23(a). He may, however, withdraw his tender within a specified time. Id. at § 13.23(b).

30. See infra Part VI.A (addressing the strategic benefits of a cash-out merger).
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 statutes 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.\(^{35}\) In all three contexts, a court is often charged with the task of assigning a price to a single share in a corporation. Specifically, the court is asked to assign a “fair value” or “fair price” to a given interest.\(^{36}\)

A. Involuntary Dissolution Statutes

Involuntary dissolution statutes create a market for stock interests where one would not otherwise exist. When a minority shareholder in a public corporation disagrees with managerial decisions, he simply sells his interest on a public exchange at the current fair market value.\(^ {37}\) A minority shareholder in a close

\(^{31}\) See supra Part 1.B (discussing available avenues to achieve judicial intervention).

\(^{32}\) See supra Part 1.B.

\(^{33}\) See supra Part 1.B.

\(^{34}\) See, e.g., OR. REV. STAT. § 60.952 (2005). In addition to oppression, the Oregon statute provides a remedy in the case of corporate deadlock, fraudulent or illegal behavior, and corporate waste. Id.

\(^{35}\) See, e.g., OR REV. STAT. § 60.554 (2005) (providing “entitle[ment] to dissent from, and obtain payment of the fair value of the shareholder’s shares . . . .”).

\(^{36}\) Compare, e.g., MODEL BUS. CORP. ACT § 13.02 (2002) (calling for payment of “fair value” during appraisal, or dissenter's rights, action), with MODEL BUS. CORP. ACT § 14.34(a) (2002) (calling for payment of “fair value” where majority elects to purchase after a petition for dissolution).

\(^{37}\) Commentators explain:

In the U.S. public markets, a security holder is able to sell a security over the telephone in seconds, usually at or within a small fraction of a percent of the last price at which the security traded, with a very small commission cost, and receive the cash proceeds within three working days.

By contrast, the universe of realistically potential buyers for most closely held minority ownership securities is an infinitesimally small fraction of the universe of potential buyers for publicly traded securities. In any case, it is illegal for a person or company to sell privately held securities to the general public without registration with either the SEC or the state corporation commission, an expensive and time-
corporation does not have a readily available market for his shares.\textsuperscript{38} At times, liquidating an interest in a close corporation can be nearly impossible due to market barriers.\textsuperscript{39} Where no market is available, a minority shareholder that is unhappy with the management of his interest has no possibility for exit. The minority shareholder is therefore “locked” into his investment,\textsuperscript{40} making him an easy target for oppressive behavior because he is neither able to direct corporate affairs, nor is he able to withdraw his investment in a reasonably efficient manner. When a controlling shareholder exploits this position, a minority shareholder can petition a court for dissolution of the corporation and proportionate distribution of its assets to the shareholders. This allows an unhappy shareholder to exit the corporation where it would have otherwise been difficult, if not impossible. The court is asked to dissolve the corporation at the behest of the minority and against the will of the controlling shareholder. Apart from dissolution, some statutes provide for a wide variety of alternative remedies for oppression.\textsuperscript{41} The most common alternative, a buy-out of the complaining party’s shares, is addressed below.\textsuperscript{42}

\begin{quote}
consuming process. Furthermore, a minority stockholder cannot register stock for public trading; only the company can register its stock for public trading.

Besides the problems of actually trying to sell the stock (and because of them), the liquidity of closely held stock is further impaired by banks and other lending institutions' unwillingness to accept it as loan collateral—as they would accept public stock.

\textsuperscript{38} Id.
\textsuperscript{39} Id.
\textsuperscript{40} One commentator explains:

If the employment of a shareholder were terminated, a classic case of being “frozen-out,” yet “locked-in,” would exist. The shareholder would be frozen-out of any participation in the earnings of the corporation since no dividends would be paid and no compensation would be earned. The shareholder would be locked-in since his capital investment would be held by the corporation with the shareholder having neither a right to withdraw nor a ready market for sale of his shares.

\textsuperscript{41} See, e.g., OR. REV. STAT. § 60.952 (2005) (providing thirteen remedies for oppression, including dissolution).
\textsuperscript{42} See O'\textsc{Neal}, supra note 2, § 1.1717 (noting that buyouts are “the most common remedy for dissension within a close corporation”); see also Douglas K. Moll, \textsc{Shareholder Oppression in Close Corporations: The Unanswered Question of Perspective}, 53 Vand. L. Rev. 749, 792 (2000) (“The most prevalent alternative remedy is the buyout of the oppressed investor's holdings.”); Murdock, supra note 40, at 470 (same).
B. The Buy-Out Remedy

Dissolving a corporate entity is a rather drastic step to take in response to an unhappy shareholder.\(^{43}\) Destroying a corporate entity against the will of its majority owners is a serious affront to managerial control and corporate independence.\(^{44}\) Furthermore, it is not economically efficient to dismantle a profit-producing business to provide an aggrieved shareholder liquidity. Where dissolution would destroy the corporation’s going-concern value, the majority will likely prefer to prevent dissolution. In this way, the dissolution remedy has the virtue of forcing the majority to bargain with the frozen-in minority.\(^{45}\) Indeed, one would expect the majority to offer to buy the minority’s stock. Perhaps in recognition of this, courts prefer alternative remedies that compensate the aggrieved shareholders while leaving the corporate entity intact.\(^{46}\) As mentioned above, the most common alternative is for the court to order one party to buy the shares of the other, providing exit without dissolving the corporate entity.\(^{47}\) The buy-out may be considered no less drastic than a dissolution, because of its similarly draconian result. However, a court ordered buy-out has the virtue of settling disputes quickly and forever. In jurisdictions that provide for the buy-out remedy in their involuntary dissolution statutes, courts are directed to determine the “fair value” of the purchased shares.\(^{48}\)

\(^{43}\) See, e.g., Balvik v. Sylvester, 411 N.W.2d 383, 388 (N.D. 1987) (“We have recognized that forced dissolution of a corporation is a drastic remedy which should be invoked with extreme caution and only when justice requires it. In a sense, a forced dissolution allows minority shareholders to exercise retaliatory ‘oppression’ against the majority.” (citations omitted)).

\(^{44}\) Id.

\(^{45}\) In this respect, liberal dissolution statutes provide the minority an opportunity to hold up the operation of the firm or the actions of other shareholders. Because few firms ordinarily hold large amounts of liquid assets, the threat of dissolution is often powerful. In effect, liberal dissolution coupled with the possibility of a court ordered buy-out provides a powerful weapon for minority shareholders. There is a substantial risk that the minority will use that power to extract more than his proportionate interest in the corporation. Letter from Stephen Bainbridge, Professor of Law, UCLA School of Law, to author (Dec. 7, 2005) (on file with author). Indeed, one court considered the possibility relevant to the application of shareprice discounts. See Advanced Commc’n Design, Inc. v. Follett, 615 N.W.2d 285, 293 (Minn. 2000) (holding that application of discount was appropriate where failure to do so would result in an unfair wealth transfer from the remaining shareholders to the minority shareholder, or where failure to do so would place unrealistic financial demands on the corporation given its present cash flow and earnings).

\(^{46}\) Id.

\(^{47}\) See supra note 42.

\(^{48}\) See, e.g., OR. REV. STAT. § 60.952(2)(k) (2005) (providing that the court may order
The same is true of the elected buy-out described above.\textsuperscript{49} When invoked, the parties are typically instructed to negotiate a price acceptable to both.\textsuperscript{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.\textsuperscript{51}

\textbf{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.\textsuperscript{52} Most importantly, a controlling shareholder has the authority to set the price offered for the shares transferred.\textsuperscript{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.\textsuperscript{54} A dissenting shareholder must follow the procedures

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{49} Id.; see also supra Part 1.C.2 (discussing the elected buy-out).
\item \textsuperscript{50} See, e.g., \textsc{Minn. Stat. Ann.} \textsection 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 . . . .”).
\item \textsuperscript{51} Id.
\item \textsuperscript{52} See, e.g., \textsc{Model Bus. Corp. Act} \textsection 11.05(a) (2002) (providing that a parent corporation controlling 90% of the outstanding shares of a subsidiary corporation can effect a merger without even having to notify the minority shareholders until after the consolidation is complete).
\item \textsuperscript{53} See, e.g., id. \textsection 11.02(c)(3) (requiring that the plan of merger include the manner and basis of converting shares into, \textit{inter alia}, cash).
\item \textsuperscript{54} The Model Business Corporation Act provides appraisal rights in the event of the following corporate actions:
\begin{itemize}
\item (1) consummation of a merger . . . ;
\item (2) consummation of a share exchange . . . ;
\item (3) consummation of a disposition of assets . . . ;
\item (4) an amendment of the articles of incorporation with respect to . . . shares that reduces the number of shares . . . owned by the shareholder to a fraction of a share
\end{itemize}
\end{itemize}
\end{footnotesize}
specified in the governing statute to trigger an appraisal.\textsuperscript{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.\textsuperscript{56}

D. \textit{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.\textsuperscript{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.\textsuperscript{58} The prevalence of this practice may lead one to conclude that the particular statutory provision considered is not determinative. However, as discussed below, the context that determines which statute is appropriate may result in different meanings attributed to “fair value,” particularly with regard to the application of share price discounts.\textsuperscript{59}

III. \textit{What Is Fair Value?}

To this point it is clear that whatever the context, the meaning

\begin{itemize}
\item \ldots [otherwise known as a reverse stock split];
\item (5) any other amendment to the articles of incorporation, merger, share exchange or disposition of assets to the extent provided by the articles of incorporation, bylaws or a resolution of the board of directors;
\item (6) consummation of a domestication \ldots ;
\item (7) consummation of a conversion of the corporation to nonprofit status \ldots ;
\item (8) consummation of a conversion of the corporation to an unincorporated entity \ldots .
\end{itemize}

\textsuperscript{55} \textit{See}, \textit{e.g.}, \textit{id.} §§ 13.21-13.23 (regarding actions necessary to trigger appraisal); \textit{see also} \textit{MODEL BUS. CORP. ACT supra} note 29 (summarizing required steps).
\textsuperscript{56} \textit{See}, \textit{e.g.}, \textit{MODEL BUS. CORP. ACT} § 13.24, 26 (2002); \textit{OR. REV. STAT.} § 60.591(1) (2005) (calling for court to determine “fair value” where the parties cannot agree).
\textsuperscript{57} \textit{Compare}, \textit{e.g.}, \textit{OR. REV. STAT.} § 60.591(1) (calling for payment of “fair value” during appraisal), \textit{with} \textit{OR. REV. STAT.} § 60.952 (calling for payment of “fair value” under involuntary dissolution statute).


\textsuperscript{59} \textit{See infra} Part V.A.
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. Despite its prevalent use in numerous dissolution and appraisal statutes, legislatures have often declined (or neglected) to define “fair value” in any useful manner. The courts are left to other means of defining this all-important term.

A. Not Fair Market Value

While “fair value” does not enjoy a universally adopted definition, many courts and commentators contend that “fair value” is not simply shorthand for “fair market value.” The most obvious reason for this distinction is the difference in terminology. If the legislature expected the court to determine the fair market value of a given interest, it could have said precisely that in the statute. It is safe to assume, so the argument goes, that legislatures are familiar with the term “fair market value” and could easily have inserted the phrase in the statutes. Therefore, the legislature must have intended a valuation other than fair market value. The most common method adopted by courts rejecting discounts values the minority interest as the proportionate share of the business as a going concern.

60. See Columbia Mgmt., 765 P.2d at 210 (noting the minimal utility of the statutory definition provided for “fair value”).
64. Id.
65. Id.
66. The Delaware Supreme Court is responsible for the following oft-quoted statement of fair value:

The basic concept of value under the appraisal statute is that the stockholder is entitled to be paid for that which has been taken from him . . . his proportionate interest in a going concern. By value of the stockholder’s proportionate interest in the corporate enterprise is meant the true or intrinsic value of his stock which has been taken by the merger. In determining what figure represents this true or intrinsic value, the appraiser and the courts must take into consideration all factors
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. Indeed, one court attributed no meaning to the minor difference in terms. In *Pohl v. Milso Manufacturing Co.*, a Milwaukee court attributed identical meanings to the terms.

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.

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. In those statutes,

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).


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 rights are available “for the shares of . . . any stock . . . either (i) listed on a national securities exchange . . . or (ii) held of record by more than 2,000 holders”); *Model Bus. Corp. Act* § 13.02(b)(1) (same);

Dissenters' rights shall not apply to the holders of shares of any class or series if the shares of the class or series were registered on a national securities exchange or quoted on the National Association of Securities Dealers, Inc. Automated Quotation
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.\textsuperscript{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 created for the benefit of minority shareholders to reach the best approximation of a “fair market value.”

IV. INTRODUCING SHARE-PRICE DISCOUNTS

Parsing the language of a particular statute does not provide a satisfactory rationale for attributing a particular meaning to “fair value.” More importantly, whether “fair value” includes marketability and minority discounts cannot be determined by scrutinizing statutory language. Defined either as an analogue to fair market value, or as a proportionate share in a going-concern, the question remains whether “fair value” leaves room for the application of share-price discounts. Before a thoughtful evaluation can be made, several preliminary questions must be answered. Two questions in particular are addressed below. First, what are share-price discounts? Second, what are they designed to accomplish?

There are four share price discounts that are repeatedly considered during “fair value” determinations and other valuation proceedings: 1) minority discounts; 2) marketability discounts; 3) key man, or key person, discounts; and 4) discounts for contingent liabilities.\textsuperscript{74} Generally, share-price discounts refer to the discounted value of an asset as reflected in the lower price of each share based

\begin{quote}
\textsuperscript{73} See supra note 72.
\end{quote}

\begin{quote}
\end{quote}
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. The two remaining discounts, although relatively established, rely heavily on fact-specific prerequisites to merit application. 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. Minority interests, by their nature, lack sufficient voting power to independently control the functions of a corporate entity. 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. Potential purchasers of minority interests may require a significant discount to compensate for the risks associated with lack of control. 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.

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.”).
In order to explore the risk of expropriation, it is useful to relate minority discounts as the converse of a control premium. 82 A control premium is an upward adjustment in share price for a controlling interest in a corporation that captures certain values that inhere in control. 83 One attribute of control is the ability to expropriate wealth from minority shareholders through fraud, illegality, self-dealing, or breaches of fiduciary duties associated with controlling interests. 84 A controlling shareholder can exercise control in a manner that captures more value of the corporation than his interest represents. For example, a controlling shareholder may pay himself an excessive salary or excessive distributions. 85 Most relevant is the possibility that a controlling shareholder will use a merger to cash-out a minority shareholder at a clearly unfair price. 86 All of these behaviors expropriate value from a minority shareholder, depriving him of the proportion of corporate benefits his shares represent. The possibility of expropriation of this kind increases in the close corporation context. 87 The lack of an available market for minority interests creates a perverse incentive for minority shareholders to ignore such behavior to a greater extent. Such behavior is more likely to occur where the possibility of reprisal is low. Thus, a potential purchaser of a minority interest will assess the possibility that such behavior will occur and will invariably insist upon a price discount to reflect that risk. 88

Minority discounts mirror two other values related to control premiums, or control generally: synergy value and pure control

82 Id. at 1273-75.
83 Id. at 1273.
84 Id.
86 See, e.g., Ex parte Baron Servs., Inc., 874 So. 2d 545 (Ala. 2003).
87 See Douglas K. Moll, Shareholder Oppression and “Fair Value”: Of Discounts, Dates, and Dastardly Deeds in the Close Corporation, 54 DUKE L.J. 293, 303 (2004) (“In a public corporation, a minority shareholder can escape these abuses of power by simply selling his shares on the market. In a close corporation, of course, there is no ready market for the company’s shares. Thus, when a close corporation investor is treated unfairly, he ‘cannot escape the unfairness simply by selling out at a fair price.’”) (quoting Daniel S. Kleinberger, Why Not Good Faith? The Foibles of Fairness in the Law of Close Corporations, 16 WM. MITCHELL L. REV. 1143, 1149 (1990)).
88 Harry J. Haynsworth IV, Valuation of Business Interests, 33 MERCER L. REV. 457, 492-93 (1982) (“A potential investor in a closely held corporation is willing to pay more for a majority interest in the business than for a minority interest because of the ability to maintain voting control and to elect a majority of directors.”).
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

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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 require a discount to reflect the absence of power and control enjoyed by majority shareholders.100

B. Marketability Discounts

A marketability discount reflects the difficulty associated with selling corporate interests for which an active market is unavailable.101 Marketability discounts are particularly relevant when discussing interests in close corporations.102 Stock interests in public corporations have a readily available market: public stock exchanges like that found on Wall Street.103 Public companies register their stock on an exchange in order to provide an active market for interests in their corporation. There, investors can easily sell their shares if they choose to end their investment in the corporation. In contrast, investors in close corporations are unable to end their investment with such ease. Shares in close corporations are not typically listed on

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99. Coates, supra note 81, at 1278 (“The term minority discount is generally used to mean the difference between the value of control shares and the value of a minority share . . . .”).

100. Haynsworth, supra note 88, at 492-93.


102. Id.

103. See, e.g., Donahue v. Rodd Electrotype Co., 328 N.E.2d 505, 514 (Mass. 1975) (“In a large public corporation, the oppressed or dissident minority stockholder could sell his stock in order to extricate some of his invested capital. By definition, this market is not available for shares in the close corporation.”); see also BLACK'S LAW DICTIONARY 344 (7th ed. 1999) (defining a public corporation as “[a] corporation whose shares are traded to and among the general public”).
public exchanges and do not enjoy the benefits of an active market.\textsuperscript{104} Increased time and expense are required to liquidate such shares.\textsuperscript{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.\textsuperscript{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.\textsuperscript{107} The difference is related to the increased liquidity associated with public stock.

Investors attach great value to the increased liquidity of public stock.\textsuperscript{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.\textsuperscript{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

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\item[\textsuperscript{104}] Donahue, 328 N.E.2d at 514; see also supra note 1 (defining the close corporation).
\item[\textsuperscript{105}] See supra note 37 and accompanying text.
\item[\textsuperscript{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.”).
\item[\textsuperscript{108}] See id.
\item[\textsuperscript{109}] Emory, supra note 63, at 1161.
\end{itemize}
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. 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. However, at least one court has drawn a distinction between oppression and appraisal disputes.

In Charland v. Country View Golf Club, the Supreme Court of Rhode Island addressed the applicability of minority and marketability discounts under the state’s involuntary dissolution statute. In Charland, a minority shareholder in a close corporation petitioned for dissolution, claiming that corporate officers had engaged in “illegal activity.” Rather than await judicial review of the initial claim, the controlling shareholders elected to buy-out the minority’s shares pursuant to the Rhode Island statute. After the election, the parties attempted to negotiate a price for the minority’s

110. See, e.g., Charland v. Country View Golf Club, Inc., 588 A.2d 609 (R.I. 1991) (considering the identity of the purchaser, that dissolution was an alternative, and wrongdoing).
111. See supra Part II.D.
112. Charland, 588 A.2d 609.
113. Id.
114. Id. at 610-13.
115. Id. at 609 (noting that the petitioner “alleged that one of the officers of the corporation was engaging in illegal activities”).
116. Id. at 609-10 (“After filing an answer, Country View, acting pursuant to § 7-1.1-90.1, elected to purchase Charland’s fifteen shares.”).
shares. As often occurs, the parties could not agree and asked the court to set a “fair value.” After appointing a first and second appraiser, the lower court rejected the application of both minority and marketability discounts. 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.

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. Relying heavily on Brown v. Allied Corrugated Box Co., and the identity of the purchaser rationale, 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.” 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).

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,” the court observed:

Many jurisdictions, including this one, have decided the question of determining fair value of shares when a dissenting shareholder elects to request the fair value of his or her share in a case of a merger or consolidation . . . . This is a separate issue from whether a minority discount should be applied when a corporation elects to buy out a shareholder who has petitioned for dissolution.

117. Id. at 610.
118. Id. at 609-10 (the Rhode Island statutes provides for “an election to purchase the shares owned by the petitioner at a price equal to their fair value”) (emphasis in original).
119. Id.
120. Id. at 612-13.
121. See id. at 612 (regarding minority discounts, the court “hereby adopt[s] the rule that in circumstances in which the corporation elects to buy out a shareholder's stock pursuant to § 7-1.1-90.1, we shall not discount the shares solely because of their minority status”).
122. 91 Cal. App. 3d 477 (1979); see also infra Part V.B.1 (discussion of Brown and the identity of the purchaser rationale).
123. Charland, 588 A.2d at 612.
124. Id.
125. Id. at 611.
proceedings.\textsuperscript{126} The court leaves open the issue of application of the minority discount in the case of an appraisal, noting a case granting “wide discretion” to consider all factors under appraisal.\textsuperscript{127} The court emphasized the compelled nature of an elected buy-out for “fair value” in contrast to the willing nature of sale during an appraisal action. Notably, in an appraisal “a dissenting shareholder elects to request” a purchase.\textsuperscript{128} There, it is the minority’s desire that his shares be purchased. Under an election, on the other hand, the minority seeks dissolution of the corporation, not the purchase of the minority’s interest. It is only at the majority’s behest that the minority sells his interest. Therefore, where the sale is not compelled, as in appraisal, discounts may be appropriate. Where the sale is forced, during an elected buy-out for example, discounts are inappropriate. Thus, context matters when evaluating the appropriateness of discounts in a given case.

Despite its logical appeal, the contextual distinction drawn by the Rhode Island court is not immune from criticism. Most notably, it is unfair to assume that any given appraisal is a willing sale by a minority shareholder as a basis to distinguish it from an elected buy-out. For example, in \textit{Ex parte Baron Services, Inc.},\textsuperscript{129} the Alabama Supreme Court addressed the application of discounts in the context of appraisal following a cash-out merger.\textsuperscript{130} The court refused to apply a marketability discount, in part, because of the compelled nature of the appraisal: “In the context of a cash-out merger, a minority shareholder is not a willing seller; instead, the minority shareholder is selling his or her shares under the compulsion of the majority shareholders who approved the merger.”\textsuperscript{131} Furthermore, in

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  \item \textsuperscript{126} \textit{Id.} at 611 n.5 (citation omitted) (emphasis in original).
  \item \textsuperscript{127} \textit{Id.} at 611 n.5 (citing Jeffrey v. American Screw Co., 201 A.2d 146 (R.I. 1964) ("appraiser given wide discretion to consider all relevant factors in determining fair value of dissenting shareholder's stock.").
  \item \textsuperscript{128} \textit{Charland}, 588 A.2d at 611 n.5 (contrasting an appraisal where the “dissenting shareholder elects to request fair value of his or her shares in case of a merger” from an elected buy-out where “a corporation elects to buy out a shareholder who has petitioned for dissolution proceedings”) (emphasis in original).
  \item \textsuperscript{129} 874 So.2d 545 (Ala. 2003).
  \item \textsuperscript{130} \textit{Id.} at 548 (“The sole issue we address on appeal is the meaning of 'fair value' under § 10-2B-13.01 . . . and whether the meaning of that term provides for the application of a marketability discount in the context of a judicial appraisal of a dissenting shareholder's shares.”).
  \item \textsuperscript{131} \textit{Id.} at 550.
\end{itemize}
Cavalier Oil Corp. v. Harnett,\(^\text{132}\) discussed in Baron Services,\(^\text{133}\) the Delaware Supreme Court draws a different picture of an appraisal than the willing nature described by the Charland court: “Where there is no objective market data available, 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.”\(^\text{134}\) While addressing the discount issue, the Delaware court noted the compelled nature of the appraisal.\(^\text{135}\) The Charland court distinguished the discount issue for appraisal, noting the willingness of the share transfer in that context.\(^\text{136}\) On the contrary, at least with respect to a cash-out merger, an appraisal for “fair value” can be tantamount to a compelled sale. Thus, distinguishing application of discounts based on the nature of the action (appraisal or oppression) does not seem to withstand scrutiny. As discussed below, every purchase for “fair value” can be described as compelled, and the compelled nature must be evaluated in each case rather than generalized according to statutory context.\(^\text{137}\)

B. Identity of the Purchaser

The minority and marketability discounts are designed to adjust the share price to compensate for the difficulty an investor would face when attempting to liquidate shares on the market.\(^\text{138}\) Some courts place great emphasis on the identity of the eventual purchaser of the valued shares when deciding whether discounts are appropriate. In almost every oppression case, there are two parties: an oppressive controlling shareholder and an oppressed minority shareholder (the oppressor and the oppressed). To some courts, the identity of the party who purchases the shares of the other is the determinative consideration when evaluating the efficacy of share price-discounts.

\(^{132}\) 564 A.2d 1137 (Del. 1989).
\(^{133}\) 874 So. 2d at 550-51.
\(^{134}\) Cavalier Oil, 564 A.2d at 1145 (emphasis added).
\(^{135}\) Id.
\(^{136}\) Charland, 588 A.2d at 611 n.5 (noting the application of discounts in the appraisal context is a "separate issue from whether a minority discount should be applied when a corporation elects to buy out a shareholders who has petitioned for dissolution proceedings").
\(^{137}\) See infra Part V.F for consideration of the compelled nature of certain buy-back transactions and the role compulsion plays in discount law.
\(^{138}\) See supra Part IV for a discussion of the intended effects of discounts.
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 The court distinguished a purchase by the controlling shareholder or corporation from a purchase by an unrelated third party, stating:

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¹³⁹. *See supra* note 42 (noting that a buy-out is the most common alternative remedy to dissolution).


¹⁴¹. *See, e.g.*, Brown, 154 Cal. Rptr. at 175-76.

¹⁴². *Id.*

¹⁴³. *Id.*


¹⁴⁵. *Id.* at 34, 38-40.

¹⁴⁶. *Id.* at 35 n. 1.
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”)).
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 control). See, e.g., MODEL BUS. CORP. ACT § 11.05(a) (2002).
151. There is room to argue that a court should determine in each case whether a controlling shareholder will increase his interest to a level providing more control (e.g., from 51% to 90%, thereby allowing short-form mergers).
dissolution, complaining of various fraudulent and unfair actions by the controlling shareholder.153 The governing statute provided for an election to purchase by the controlling shareholder in lieu of dissolution.154 Rejecting the application of the minority discount,155 the court noted the fact that the controlling shareholder would be the eventual purchaser of the minority interest.156 After observing that there is “no question” that lack of control substantially decreases the value of a minority interest if placed on the market, the court explains:157

It has been noted, however, that the rule justifying the devaluation of minority shares in closely-held corporations for their lack of control has little validity when the shares are to be purchased by someone who is already in control of the corporation. In such a situation, it can hardly be said that the shares are worth less to the purchaser because they are noncontrolling.158

Just as in the Indiana court did in Wenzel, the Brown court failed to recognize the realities of corporate control and that further consolidation of a presently controlling interest has little impact. As explained above, the shares purchased by a controlling shareholder have little or no increased value compared to the same shares in the hands of the minority. A controlling shareholder can expropriate value and enjoys pure control before further consolidating his interest. Regardless of their eventual owner, the transferred shares do not convey control and should be discounted to reflect that fact.

ii. Purchase by the Oppressed Party

In most cases where the court is called upon to set a “fair value,” a controlling shareholder, or oppressor, purchases the shares from the

153. Id. at 172 (“Plaintiff's complaint for involuntary dissolution charged . . . Brown with various acts of fraud and unfairness towards them, including inter alia his establishment of a business to compete with Allied's, his failure to cause the corporation to pay dividends, and his taking of excessive salary as president of Allied.”).

154. Id. at 172 n.1; see also former CAL. CORP. CODE § 4658 (1979) (providing that a controlling shareholder “may avoid the . . . dissolution of the corporation by purchasing the shares of stock owned by the plaintiffs at their fair cash value”).

155. Id. at 175 (describing a minority discount as a “devaluation for lack of control”).

156. Id. at 175-76.

157. Id. at 175 (noting that the court observed that “[a]s a practical matter, there is no question but that the lack of control inherent in plaintiff's minority shares would substantially decrease their value if they were placed on the open market”).

158. Id. at 176 (citing Julia Rider, Comment, Dissolution Under the California Corporations Code: A Remedy for Minority Shareholders, 22 UCLA L. REV. 595, 611 n. 62 (1975)).
minority, or oppressed, shareholder. However, in Balsamides v. Protameen Chemicals, Inc., the Supreme Court of New Jersey affirmed an order that the oppressor sell his shares to the party initially seeking dissolution. Most importantly, the court upheld the application of a marketability discount where the oppressed party is the purchaser.

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

The primary issue on appeal was whether in a judicially ordered buy-out, the “trial court should have applied a ‘marketability discount’ to determine the ‘fair value’ of the oppressor’s shares.” Sustaining application of the discount, the court considered the identity of the purchasing party in this particular case. The court noted that a marketability discount could apply even to a controlling interest, because “the field of potential buyers is small, regardless of the size of the interest being sold.” Therefore, despite his newly consolidated control, “[b]y not applying a marketability discount . . . the remaining [oppressed] shareholder will have to absorb the full reduction for lack of marketability when he sells the company at a future date.” Rather, the court contends, the oppressor should share the burden of illiquidity evenly with the oppressed party. Thus, a

159. 734 A.2d 721 (N.J. 1999).
160. Id. at 738.
161. Id. at 735-36.
162. Id. at 722.
163. Id. at 723 (“In June 1995, Balsamides sought relief as an oppressed minority under N.J.S.A. 14A:12-7.”).
164. Id. at 723-24 (noting that the “trial court found that Balsamides was an oppressed shareholder under [the New Jersey statute] and was entitled to buy-out Perle’s interest” in the corporation for a specified amount).
165. Id. at 723-25
166. Id. at 722.
167. Id. at 735.
168. Id. at 733.
169. Id. at 735.
170. Id. at 735-36.
35% discount for marketability was applied in order to spread the burden of illiquidity, inherent in close corporations, between the two parties. 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.” 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.” 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.”

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 example, assume the court orders the oppressor to purchase the complaining party’s interest at an undiscounted value. The complaining party would receive a price for his shares that fails to account for their lack of marketability. At a later sale, the oppressor would suffer the full weight of the illiquidity, and will receive a lower purchase price because of the company’s closely held nature. Thus, regardless of the purchasing party, the economic realities dictate that a marketability discount is “fair” to all parties involved because it spreads the burden of decreased marketability among every shareholder. The Balsamides court unduly focused on the identity of the purchaser when evaluating the applicability of discounts. The court did not base its decision on economic realities, rather it took account of wrongdoing and effectively punished the oppressor by applying a marketability discount. Preferably, the court would announce its purpose to punish the wrongdoer, rather than cloak its intent.

171. Id. at 736 (noting that a “thirty-five percent marketability discount” was appropriate).
172. Id.
173. Id. at 735.
174. Id. at 736.
175. Id.
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, and proceeded to determine the “fair value” of the minority shares in question. The Oregon Court of Appeals affirmed the trial court’s refusal to adjust the purchase price to reflect minority and marketability discounts. 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.”

The *Chiles* court then observes that in *Columbia Management v. Wyss*, an Oregon court applied a 33% discount “when there was no evidence of misconduct.” 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.

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

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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.
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]...
was the oppressed shareholder.”

By focusing on the wrongdoing of one party, both the Chiles and Balsamides courts effectively used the application of discounts as a punitive measure. Where the oppressor is the purchasing party, the discount is rejected because of his wrongdoing. Where the oppressed is the purchasing party, the discount is appropriate to account for the opposing party’s wrongdoing. Punishing a party for oppressive behavior, or after a cash-out merger, is not improper unto itself. However, as explained below, using the application or rejection of any discount is an inappropriate, rough approximation that confuses the valuation issue.

First, the application of the marketability discount adjusts share value to account for the various difficulties a seller would face if he attempted to liquidate his interest. The discount is not related to good or bad conduct, it is an adjustment based on prevailing market conditions. The same can be said of the minority discount, whose application turns on the presence or lack of control, not judgments regarding conduct. Therefore, it is conceptually inappropriate to apply or reject a given share-price discount as a method of punishment for oppressive or unfair conduct.

Furthermore, courts seeking to punish one party for oppressive conduct should do so through some other method that does not incorporate discounts. For instance, a court can award punitive damages, and identify them as such. As one commentator notes:

Admittedly, this suggestion might not significantly alter the total award of relief. Courts might simply recharacterize the amount of the marketability discount as a punitive damages award . . . . Even a mere recharacterization . . . would have some benefit, as a court’s effort to punish an oppressive investor would be more clearly identified rather than obscured within a discount analysis.

Indeed, the Balsamides court awarded the oppressed party $75,000 as punitive damages for the wrongful conduct. This award could have been adjusted upward, leaving application of the discount to economic considerations. Doing so would have avoided confusion

189. Id. at 736.
190. See, e.g., Chiles, 767 P.2d 903.
191. See, e.g., Balsamides, 734 A.2d 721.
193. Balsamides, 734 A.2d at 726.
of the discount issue in later cases.

Finally, the punishment rationale is particularly inappropriate where a controlling shareholder elects to buy the minority shares and avoid a dissolution action. Because the election occurs prior to the litigation of an oppression claim, oppressive conduct by one party will not have been established. At that point, oppressive conduct described in the complaint is a mere allegation. In both Chiles and Balsamides, oppressive behavior had been established prior to the valuation.\textsuperscript{194} It would be inappropriate to refuse a fair adjustment to the value of the purchased shares based on mere allegations of oppressive conduct by a controlling shareholder. Instead, rejection of the discount in the election context should be contingent on more principled considerations.

D. Distinguishing Corporate-Level from Shareholder-Level Discounts

Share-price discounts have been further categorized as either shareholder-level or corporate-level discounts.\textsuperscript{195} The basis for the categorization, and the resultant divergent treatment, is tenuous at best. Future courts are well guided to ignore any technical distinction when setting "fair value." Shareholder-level discounts involve varying "fair value" based on the characteristics of the shares in the hands of particular shareholders.\textsuperscript{196} On the other hand, corporate-level discounts apply to the corporation as a whole, affecting all shares equally, regardless of their holder’s position.\textsuperscript{197}

In Cavalier Oil, the court rejected shareholder-level discounts because "fair value" is not dependent upon the characteristics of the particular shares being valued.\textsuperscript{198} Delaware case law requires that

\textsuperscript{194} Chiles, 767 P.2d at 926 ("We require defendants to purchase plaintiffs’ interests because of their breach of duty to plaintiffs"); Balsamides, 734 A.2d at 724 ("Numerous other actions by Perle . . . constituted a breach of his fiduciary responsibility . . . amounting to shareholder oppression.").

\textsuperscript{195} See, e.g., Cavalier Oil v. Harnett, 564 A.2d 1137, 1144 (Del. 1989).

\textsuperscript{196} Id.

\textsuperscript{197} Id.

\textsuperscript{198} Id. ("In rejecting a minority or marketability discount, the Vice Chancellor concluded that the objective of . . . [an] appraisal is 'to value the corporation itself, as distinguished from a specific fraction of its shares as they may exist in the hands of a particular shareholder.' We believe this to be a valid distinction.") (emphasis in original).

In Cavalier Oil the court stated that appraisal is intended to value the corporate entity, not the shares held by a particular shareholder. 564 A.2d at 1144. The court's conclusion seems clearly contrary to the statutory text, which calls for the fair value of "the stockholder's
“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:

Under those specific circumstances, this Court held that a discount had to be applied to the net asset value of the company in order to arrive at the true or intrinsic value of that particular company’s stock. However, no discounts were applied at the shareholder level. The application of a discount to a minority shareholder is contrary to the requirement that the company be viewed as a

shares.”  DEL. CODE ANN. tit. 8, § 262(a). Specifically, section 262(g) requires the court to determine which shareholders are entitled to appraisal. Section 262(g) further provides that the court may order such shareholders to surrender their shares, if held as certificates, “to the Register in Chancery for notation thereon of the pendency of the appraisal proceedings.” Section 262(h) provides: “After determining the stockholders entitled to appraisal, the Court shall appraise the shares . . . together with a fair rate of interest, if any, to be paid upon the amount determined to be the fair value.” Id. § 262(h). The reference to the shares clearly does not refer to the entity, but rather to the shares held by those stockholders who have perfected their appraisal rights. Letter from Stephen Bainbridge, Professor of Law, UCLA School of Law, to author (Dec. 7, 2005) (on file with author).

If the Cavalier Oil court was correct, however, its understanding of appraisal’s purpose argues against a minority discount, because the question of whether the shares are held by the minority or majority shareholder is irrelevant to the value of the entity as a whole. In contrast, the analysis should permit the application of marketability discounts, because the entity as a whole is worth less due to the illiquidity of its shares. Curiously, the Cavalier Oil court rejected both minority and marketability discounts. The opinion treats the two discounts as one and the same, perhaps reflecting a lack of understanding of the conceptual differences between the two. Id.

199. Id. (requiring courts to determine a shareholders “proportionate interest in a going concern” (citing Tri-Continental Corp. v. Battye, 74 A.2d 71, 72 (Del.1950))).

200. Tri-Continental Corp., 74 A.2d at 75-76.
“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

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.
complainant would have received had dissolution occurred.206

In Brown, the court’s decision to reject the minority discount hinged on the notion that the buy-out is an alternative to a sought after dissolution.207 There, minority investors petitioned for dissolution after the controlling shareholder engaged in various oppressive practices.208 Rather than await a judicial resolution, the controlling shareholders elected to buy-out the minority shares pursuant to California’s statute. While addressing the appropriateness of a minority discount, the court explained:

Had plaintiffs been permitted to prove their case and had the corporation been dissolved, it is clear that upon distribution of the dissolution proceeds each of the shareholders would have been entitled to the exact same amount per share, with no consideration being given to whether the shares had been controlling or noncontrolling.209

The court noted that share-price discounts would not be appropriate in a dissolution because the corporation would be liquidated and the assets distributed proportionately.210 Therefore, in order to bring the elected buy-out in congruence with a dissolution, no discounts should be applied in either context.211 “Rather, the statutes suggest that a minority shareholder who brings an action for dissolution of a corporation should not, by virtue of the controlling shareholder’s invocation of the buy-out remedy, receive less than he would have received had the dissolution been allowed to proceed.”212

In Charland, the Rhode Island court similarly observed that a buy-out is an alternative to dissolution while rejecting the application of a marketability discount.213 The court condemns the application of the discounts, borrowing heavily from recent scholarship. The Rhode Island court quotes, with approval, the following:

In dissolution cases, strong reasons support the use of pro rata value without a discount . . . . A minority shareholder seeking dissolution claims that majority shareholders have engaged in some unfair, possibly tortious, action. If the minority shareholder

206. Charland, 588 A.2d at 612.
207. Brown, 154 Cal. Rptr. at 176.
208. Id. at 172.
209. Id. at 486.
210. Id.
211. Id.
212. Id. at 487.
213. Charland, 588 A.2d at 609.
succeeds in having the company dissolved, all shareholders will receive their pro rata share of the assets, with no account given to the minority [or illiquidity] status of their shares. Minority shareholders should not receive less than this value if, instead of fighting the dissolution action, the majority decides to seek appraisal of minority shares in order to buy-out the minority and reduce corporate discord.\(^\text{214}\)

Just as the court did in \textit{Brown}, the \textit{Charland} court equates “fair value” with the value the minority shareholders would have received had their dissolution action been successful.\(^\text{215}\) This argument, if applied broadly, would require reliance on several tenuous assumptions described below.

First, the argument is based on the incorrect assumption that the underlying petition for dissolution carried merit and would have been successful. The courts assume that the party seeking dissolution had indeed been wronged and was therefore entitled to an equitable remedy. However, a court should not assume that the claimants would have prevailed while setting “fair value.” The nature of an election to purchase is pre-emptive; the controlling shareholder does not intend to await judicial resolution of the underlying claim. Instead, perhaps to quickly eliminate potentially injurious “corporate discord,” the controlling shareholder invokes the buy-out. An elected buy-out should not be considered an admission of guilt or wrongdoing. Indeed, expeditiously reducing corporate discord is of itself a compelling reason for the controlling shareholder to invoke an election. Disharmony among shareholders can have serious effects on the operation of the corporation. By eliminating the complaining shareholders immediately after initiation of the dissolution action, the corporation regains its ability to function sooner rather than later.

Furthermore, invoking the elected buy-out reduces the risk and expense involved in dissolution actions. For example, assume that there is some level of uncertainty regarding whether the controlling shareholder had behaved oppressively in a given dissolution action. Rather than await a judicial resolution, possibly some many months (or years) in the future, which may result in dissolution of the corporation, the controlling shareholder may invoke the election. By doing so, the controlling shareholder eliminates the possibility of dissolution, reducing the risk of the action entirely. The very worst

\(^{214}\) \textit{Id.} at 613 (citing Heglar, \textit{supra} note 25, at 269 n.63).

\(^{215}\) \textit{Id.}
result of the election is that the court will exclude discounts while settling on a “fair value.” A risk averse controlling shareholder may very well elect to buy the minority out entirely due to personal proclivity. Therefore, no assessment of wrongdoing should accompany an election.

A second erroneous assumption is common to the Charland and Brown rationales. Simply put, both courts assume that a finding of liability in a dissolution action necessarily leads to dissolution. However, most contemporary involuntary dissolution statutes provide an assortment of possible remedies, including buy-out. In addition, even absent statutory authority, courts have ordered buy-outs to avoid dissolution. Therefore, success in a dissolution action should be regarded as a victory that may result in, among other things, the dissolution of the corporation. Viewed in that light, every available remedy is given its own meaning, rather than one related to dissolution. A court would be unable to assume that, absent the election to buy-out, the corporation would have been dissolved had the minority complainants been successful.

Additionally, the dissolution analogy weighs against approximating “fair value” with a proportionate interest in the corporation as a going-concern as a basis for rejecting discounts, as many courts have done in the past. Had the minority been successful in dissolving the company, certain market imperfections intrinsic to dissolution sales may have the effect of reducing the value of the company from that it enjoyed as a going-concern. First, one cannot assume that when liquidated, the company will be sold off wholesale, as a going-concern, rather than on a piecemeal basis. It is common for companies to sell off individual assets when they encounter difficulty selling the entire entity. Doing so results in a loss of values attributable to the combination of those particular assets, or

216. Charland, 588 A.2d at 612; See Brown, 154 Cal. Rptr. at 176.
217. The governing statutes in both Charland and Brown provided for an elected buy-out in lieu of dissolution. Charland, 588 A.2d at 609-10; Brown, 154 Cal. Rptr. at 172 n.1; see also OR. REV. STAT. § 60.952 (2005) (providing twelve alternatives to dissolution).
219. See supra note 66 and accompanying text.
220. Moll, supra note 42, at 49 (“In a dissolution proceeding, a company is sold—either intact as an operating business (or ‘going-concern’), or piecemeal on an asset-by-asset basis.”); see also Brown, 154 Cal. Rptr. at 178 (“[H]ad the corporation been dissolved, its liquidation might very well have been accomplished by a piecemeal sale of its assets.”).
SHARE-PRICE DISCOUNTS AND CORPORATE BEHAVIOR

synergies. This can have the effect of reducing the total value of the individual assets below that which they would have been worth in harmony. Second, investors looking to purchase a dissolving company may attach negative implications to the nature of the sale. Dissolution is definitely not an indicator of a healthy, profitable going-concern. Rather, investors may insist upon a price adjustment to account for intangible risks associated with dissolving entities. The possibility of piecemeal dissolution, along with various intangible factors, should discourage a court from equating “fair value” with a proportionate interest in the going-concern as a basis for rejecting discounts.

F. Compelled Nature of Share Transfer

Particularly in the appraisal context, courts have emphasized the compelled nature of a transfer for “fair value.” An appraisal action can arise where a controlling shareholder proposes a merger that exchanges a minority shareholder’s interest in a corporation for cash, eliminating the shareholder’s involvement and investment in the corporation. As one court notes, “[i]n the context of a cash-out merger, a minority shareholder is not a willing seller; instead the minority shareholder is selling his or her shares under the compulsion of the majority shareholders who approved the merger.”

Courts have utilized the compelled nature of a merger transaction to reject the application of marketability discounts. For example, in Ex parte Baron Services, the Supreme Court of Alabama

221. See supra Part IV.A (discussion of “synergy value”).
222. One commentator notes several other imperfections associated with a dissolution sale:
Market imperfections in a dissolution sale . . . may lead to much lower values for the company than a going-concern valuation outside of dissolution. Indeed, “[b]uyers generally are unwilling to pay full value for a business at a judicial sale even though it is a going concern.” Such unwillingness stems from the following risks: (1) the risk of losing the management team shortly after sale, (2) the risk of receiving inadequate or inaccurate financial statements prior to purchase, (3) the risk of competition from the seller, and (4) the risk of adverse changes from abnormal operation of the business before the purchase is completed.
Moll, supra note 42, at 349 (notes omitted).
223. Id.
224. Id.
225. See, e.g., MODEL BUS. CORP. ACT § 11.02 (permitting a merger wherein shareholders receive cash for their shares, rather than an interest in the surviving entity).
226. Baron Servs, 874 So.2d at 550.
rejected the application of a marketability discount while determining “fair value” pursuant to a dissenter’s rights statute.\textsuperscript{227} Citing \textit{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.”\textsuperscript{228} This is so because a minority shareholder must have dissented to the merger proposal in order to reach the appraisal stage.\textsuperscript{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.\textsuperscript{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 and sold to a third party, the proportionate interest would reflect the lower price received because of the inherent illiquidity of close corporations.\textsuperscript{231} The minority shareholder should equally suffer from the diminished value of the corporation when he seeks to liquidate his interest through dissolution.

\begin{itemize}
  \item \textsuperscript{227} \textit{Id.} at 552.
  \item \textsuperscript{228} \textit{Id.} at 550-51 (citing \textit{Cavalier Oil}, 564 A.2d at 1144) (emphasis added).
  \item \textsuperscript{229} See, e.g., \textsc{Model Bus. Corp. Act} § 13.21(a)(2) (“a shareholder who wishes to assert appraisal rights . . . must not vote, or cause or permit to be voted, any shares . . . in favor of the proposed action”); \textsc{Or. Rev. Stat.} § 60.564(1) (same).
  \item \textsuperscript{230} \textsc{Black's Law Dictionary} 1549 (7th ed. 1999) (defining fair market value as “[t]he price that a seller is willing to accept and a buyer is willing to pay on the open market in an arm's-length transaction”).
  \item \textsuperscript{231} \textit{See supra} note 222 (providing reasons for lower value at dissolution sale).
\end{itemize}
The same is true where the court orders, or the controlling shareholder elects, a buy-out of the minority in a dissolution action. In both cases, the minority shareholder sought to dissolve the company and end his investment in the corporate entity. The majority simply steps in to eliminate the minority more quickly. Regardless of the selected remedy, a minority shareholder who petitions for dissolution is not compelled to sell his interest. On the contrary, the goal of a dissolution action is to end the investment. The company would no longer have been a going-concern if the minority was successful, and his interest should not be valued based on the assumption that he would have maintained an interest in the company if given the option.

VI. Effect of Rejecting Discounts in Every Context

Equal application, or rejection, of discounts in every context will encourage cash-out mergers over elected buy-outs, largely avoiding dissolution actions. If a court approaches the discount issue identically in every context (election, oppression, and appraisal), it would limit the possibility that an involuntary dissolution action would be pursued. The chance that the litigation will result in dissolution, however slim, will cause a controlling shareholder to elect a buy-out, or effect a merger, rather than hope the court will order a buy-out at “fair value.” If “fair value” is the same after an oppression case as in an elected buy-out, a controlling shareholder will prefer an election to eliminate risk and reduce litigation expenses. This has the further effect of preventing acrimonious allegations from entering the public record, to an admittedly minimal degree. Therefore, the two options that eliminate the risk of dissolution, election and merger, remain for comparison.

A. Reviewing the Benefits of Cash-Out Mergers Over Elected Buy-Outs

Once again assuming equal treatment of discounts, we turn to consideration of the relevant features, if any, which distinguish a cash-out merger from an election to buy-out the minority. Professor Robert C. Art poignantly captures the opinion of one leading Oregon practitioner, a state whose dissolution statute includes an elected buy-out,232 in the following comments:

232. OR. REV. STAT. § 60.952(6) (providing for election to buy-out).
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. However, as noted earlier235, the ability to effect such a transaction may require an interest greater than 51%, thus limiting the application of this argument to situations where a controlling shareholder enjoys a supermajority position.

After the minority is cashed-out in the merger, his only option to liquidate his interest for fair value, and exit the corporation, may be to perfect his appraisal rights under the relevant dissenter’s rights statute.236 One may argue that a cash-out merger should itself be considered oppressive behavior. As Professor Art observes, even assuming the transaction was oppressive, many states limit a shareholder to an appraisal action, where oppression claims are often barred.237 Therefore, a controlling shareholder may be able to


234. Id.

235 See supra Part IV.A

236. See, e.g., OR. REV. STAT. § 60.554(2) (“A shareholder entitled to dissent and obtain payment for the shareholder's shares . . . may not challenge the corporate action creating the shareholder's entitlement unless the action is unlawful or fraudulent with respect to the shareholder or the corporation.” (emphasis added)); cf. Onti, Inc., v. Integra Bank, 751 A.2d 904, 930 (Del. 1999) (Delaware law “allows a plaintiff in a cash-out merger to file, in addition to an action for appraisal, a claim for violation of entire fairness by the corporation or its board of directors”).

237. Art, supra note 20, at n.311. The Supreme Court of Oregon has held that appraisal is the exclusive remedy following a cash-out merger:

Where the allegations show only a disagreement as to price, however, with no
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
are only available at the time of election. 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. 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. Other arguments are equally weak in all three contexts. Thus, there are some conceptual reasons to argue that discounts are more appropriate in the election context than they are in oppression or appraisal actions. The question remains whether it is wise to seize upon the minor conceptual distinctions to support the application of discounts in the election context.

C. Why Encourage Elected Buy-Outs?

It was noted earlier that if discounts were applied equally in election and merger cases, mergers, for various reasons, would likely be preferred. However, courts can encourage the election to purchase by applying share-price discounts to an elected buy-out while rejecting them in oppression and appraisal actions generally. The elected buy-out is arguably the most efficient, least acrimonious, and most likely method to achieve a fair result for all parties involved in a given oppressive situation. An election reduces the all-or-nothing risk of litigation for both parties by providing a specific remedy; a purchase for “fair value.” The “fair value” determination is done with court oversight, feasibly encouraging a fair result. An election has the effect of reducing litigation expenses for both parties. In particular, the possibility that a minority shareholder would have to pursue two separate actions to advance his interests is eliminated, as may occur if a cash-out merger is effected. Additionally, without some kind of judicial encouragement of the election to buy-out, the provision is not likely to be utilized as often as its drafters intended. For these reasons, it may be beneficial to every potential dissolution litigant for courts to encourage majority interest holders to buy-out

241. See supra Part IV.C.
242. See supra Part IV.E.
243. See supra Part IV.F.
244. See supra Part IV.D.
245. See supra Part VI.
246. See supra Part I.C.2 (discussing the benefits of an elected buy-out).
247. See supra note 238.
the minority at “fair value” and end disputes post haste. However, using discounts is not a principled method of encouraging elections. The values that can be associated with the efficiency of election bear no relation to marketability and minority discounts. Using discounts to encourage election is as inappropriate as using discounts as a method to punish perceived, or proven, wrongdoing. Nonetheless, many courts do consider equity when setting “fair value.” Just as a wrongdoer’s discount is rejected in light of equitable considerations, a controlling shareholder who elects to buy-out the minority should benefit from his quick and efficient resolution and receive the appropriate discounts.

VII. CONCLUSION

Shareholder oppression is unfortunate whenever it occurs. However, after accepting oppression, or allegations of oppression, as an inevitable result of close corporations, courts can focus their attention on efficient resolution when it does occur. After an involuntary dissolution action is initiated, controlling shareholders have difficult decisions to make regarding the most efficient course of action. Equal application of discounts in every context encourages controlling shareholders to cash-out minorities and force them to pursue an appraisal, rather than purchase their interests for “fair value” at the outset. By applying discounts when a controlling shareholder elects a buy-out prior to litigation, courts can encourage shareholders to make the decision to elect. Doing so will result in more efficient resolution, avoidance of acrimony, and less disruption of on-going business. Although applying discounts is not the best way to encourage election, it is a possibility that merits consideration.

248. See, e.g., Lawson Mardon Wheaton, 734 A.2d 738, 748 (N.J 1999) (“The very nature of the term “fair value” suggests that courts must take fairness and equity into account in deciding whether to apply a discount.”); Advanced Comm. Design, 615 N.W.2d 285, 292 (Minn. 2000) (“Our statutory scheme in court-ordered buy-outs is clearly directed towards providing the court maximum flexibility to fashion a remedy 'fair and equitable to all parties.'”).

249. See, e.g., Lawson Mardon Wheaton, 734 A.2d at 738.