

Bench Press

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Share & Share Alike

Justice prevails in the world of minority shareholder interests.

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MAJORITY RULE DETERMINES MANY THINGS IN LIFE, AND CORPORATE governance is no exception. In some cases, it has such a great influence that corporations may even reduce the number of minority shareholders in order to qualify for Sub Chapter S Status, or to eliminate the administrative expense and delay of communicating with minority shareholders. But the minority does have some say.

Under certain circumstances, the Illinois Business Corporation Act provides that those dissenting from corporate action are entitled to have their shares purchased by the corporation for "fair value." A question arises, though, as to whether the fair value concept encompasses the illiquidity typically encountered by those who own shares in a closely held business, and the inherent minority status of those who dissent.

For this reason, Illinois has developed a body of case law to address the fair value concept, an excellent discussion of which is provided in *Weigel Broadcasting Company v. Smith, et al.*, 289 Ill.App.3d 602, 682 N.E.2d 745 (1st Dist. 1997). In this case, 83 percent of stock ownership was held by the company president and his family members, and the remaining 17 percent was divided amongst 143 shareholders. The corporation's board of directors sent a notice to shareholders, informing them that it was proposing a reverse stock split, whereby 1,750 old shares would be redeemable for one new share. Anyone holding less than 1,750 shares would turn in their shares for cash; no fractional shares were allowed.

Due to the conflict of interest between the controlling and the minority shareholders, the board hired an independent valuation-consulting firm, which determined the fair value of each share to be \$115.

The board also reserved the right not to proceed with the reverse stock split if enough minority shareholders declined to accept the per-share offer. Most of the minority shareholders accepted the \$115 buy-out price, but for those remaining minority shareholders who chose to exercise their dissenter's rights, the corporation filed a

petition asking the Court to determine and declare fair value.

At the petition's hearing, the corporation's expert testified that all factors had to be considered when determining fair value, including discounts for illiquidity (i.e. the lack of an open market for the shares) and a lack of control (i.e. minority status). In contrast, the dissenting minority shareholders presented an expert who testified that the fair value of the shares was a simple pro rata division of the corporate assets without any discounts. This second expert valued the shares at \$578. The trial court found the corporation's expert testimony to be "more credible," and the stock's fair value was set at \$126.

In affirming the trial court, the Appellate Court noted that the Illinois Business Corporation Act provides no statutory definition of "fair value," but rather states only that the term "means the value of the shares immediately before the consummation of the corporate action to which the dissenter objects, excluding any appreciation or depreciation in anticipation of the corporate action, unless exclusion would be inequitable."

While stating that the fair value determination is an inexact science involving many subjective and complex determinations, the Appellate Court concluded that all relevant factors may be considered in valuing the stock, including earning capacity, investment value, history and nature of the business, economic outlook, book value, dividend paying capacity, and market price of the stock of similar businesses.

The Appellate Court also stated that the trial court has broad discretion to consider the application of minority and illiquidity discount factors, and that the trial court also may consider that, in this instance, the dissenters did not assert any claim of oppressive corporate conduct. Also questioned was the issue of whether the trial court's valuation was against the manifest weight of the evidence; the Appellate concluded that, here, it was not.

Professionals and shareholders of closely held corporations in Illinois can learn valuable lessons from the *Weigel Broadcasting* decision, which stands as a reminder that the trial court's discretion is broad, and that all factors may be considered. Certainly, the corporation's position was bolstered by the independent valuation performed before litigation was initiated, by reserving its right not to proceed with the transaction if many of the minority shareholders rejected it, and by its expert being found to be the more credible.

For those who value corporations' shares, *Weigel Broadcasting* serves as a judicial reminder of the steep discounts that may apply to minority interests. For all involved, the case highlights the fact that, above all, it is fairness and credibility that truly counts. □

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