
Business Split-Ups

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Fannon Valuation Group

The numbers don't lie
...we tell their story.

What causes disputes?

- Different directions of Principals
- Failure to define clarity between “owner” hat and “employee” hat
- Too many hands in the pie
 - “Third generation” syndrome
- “Bobby worked harder than Susie”
- “We have a failure to communicate”
- Compensation is often a factor

Split-ups

1. Corporate divorce by mutual agreement
2. Shareholder Dissent
3. Judicial Dissolution

Valuation in the context of corporate divorce by mutual agreement

- Look to the terms of the corporate documents first
- Shareholder agreement (C and S corps)
- Operating agreement (LLC's)
- By-Laws and Articles of Incorporation
- State Law where agreements are silent

An Ounce of Prevention...

- Shareholder Agreements
- Ideally:
 - Done in advance
 - Original Intentions of the Parties
- Reality:
 - Don't get done at all, or
 - Meaning of terminology gets lost

Agreements between the owners

- Often cause more confusion than clarity regarding valuation
- Often leave the door open for significant conflict
- Often don't speak to the *intentions* of the parties—at least their intentions when they're breaking up

Standards of Value for Agreements

- First: define what you mean
- Fair market value?
- Fair value?
- Strategic value?
- ...of the shares? with discounts? For what?

- Whatever you use—define it.

Options for valuation

- Formula—problematic
- Negotiation between parties—usually difficult
- Single appraisal—risky
- Three appraisers (by seller, buyer, and third)—costly
- Two appraisers, averaged—incentive to go high or low on either side

Good options for valuation

- Two appraisers, but the seller must be willing to buy at seller's appraised value, and buyer must be willing to sell at buyer's appraised value (usually in 50/50 situations) (encourages fairness on both sides)
- Annual valuation that parties agree to in writing (consider periodic "formal" valuation)

Shareholder Dissent

- A shareholder is entitled to dissent from, and obtain payment of the **fair value** of his shares in the event of, upon the occurrence of certain corporate actions

- see materials for actions...

Judicial Dissolution

- **293-A:14.30 Grounds for Judicial Dissolution**

- **(b) In a proceeding by a shareholder if it is established that:**

- (i) The directors are deadlocked** in the management of the corporate affairs, the shareholders are unable to break the deadlock, and irreparable injury to the corporation is threatened or being suffered, or the business and affairs of the corporation can no longer be conducted to the advantage of the shareholders generally, because of the deadlock.

- (ii) The shareholders are deadlocked** in voting power and have failed, for a period that includes at least 2 consecutive annual meeting dates, to elect successors to directors whose terms have expired.

- (iii) The directors or those in control of the corporation have acted, are acting, or will act in a manner that is illegal or fraudulent.**

- (iv) An agreement under the provisions of RSA 293-A:7.32(a)(7) binding on all the shareholders so provides.**

“...the corporation may elect or, if it fails to elect one or more shareholders may elect to purchase all shares owned by the petitioning shareholder at the **fair value** of the shares” (293-A:14.34 Election to Purchase in Lieu of Dissolution)

Fair Value

- **Fair Value:** (Chapter 293-A, 293-A:13.01 Definitions)
- “the value of the shares immediately before the effectuation 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”

In Re Valuation of Common Stock of McLoon Oil Company, 565 A.2d 997, 1004 (Me. 1989)

- “[i]n the statutory appraisal proceeding, the involuntary change of ownership caused by a merger requires as a matter of fairness that a dissenting shareholder be compensated for the loss of his proportionate interest in the business as an entity. The valuation focus under the appraisal statute is not the stock as a commodity, but rather **the stock only as it represents a proportionate part of the enterprise as a whole.** The question for the court becomes simple and direct: What is the **best price a single buyer could reasonably be expected to pay for the firm as an entity?** The court then prorates that value for the whole firm equally among all the shares of its common stock. **The result is that all of those shares have the same fair value.**” (emphasis added)

What are the issues that arise?

- What are the appropriate methods to use in an appraisal process?
- Do strategic purchasers get included in the mix?
- Should synergistic effects of a merger be included?
- Discounts
-or not?
- Sometimes mixed in with employment claims

Are the principles of valuation the same as fair market value?

- Generally talking about same three methods we're always talking about
- Income approach
- Market approach
- Net asset approach

Methods:

Paskill Corp. vs. Alcoma Corp.

No 321, 1999, 2000 Del., March 7, 2000

- The court stated that the value must account for:
 - leverage;
 - discount;
 - net asset value;
 - market value;
 - management;
 - earnings and dividends;
 - expenses of operation;
 - particular holdings in the portfolio; and
 - a favorable tax situation.

Paskill Corp. vs. Alcoma Corp. - No 321,
1999, 2000 Del., March 7, 2000

- In this case Alcoma valued the company by use of the net asset value, the use of which Paskill did not object
- The case was appealed on other grounds
- The Delaware Supreme Court reversed and remanded the case on the use of "net asset value" to determine the "fair value"
- Even though this was not an issue raised by the parties

Paskill Corp. vs. Alcoma Corp. - No 321,
1999, 2000 Del., March 7, 2000

- The court felt the "net asset value" approach is a form of "liquidation" analysis, and
- Cannot be the sole measure of value in a statutory appraisal proceeding
- And the focus must be on a *going concern* basis

Strategic Purchasers:

Gagliano vs. Brennan - N.J. Super. Ct.

App. Div., August 1, 2001

- Delaware law does allow consideration of control premiums.
- Delaware Supreme Court has cautioned that a premium can't be used as way to capture synergistic effects of a merger.

Discounts

- Most states reject discounts for Lack of Control and Lack of Marketability

Hansen v. 75 Ranch Company

No. 97-249, 1998 WL 180831 (Supreme Court of Montana, April 9, 1998)

- “inherently **unfair to the minority shareholder who did not pick the timing of the transaction and is not in the position of a willing seller**. Thus, these courts hold that a dissenting shareholder's position should be the equivalent of what it would have been had the fundamental change not occurred. Moreover, they reason that valuing the shares at less than their proportionate share of the corporation's fair value produces a transfer of wealth from the minority shareholder to the shareholders in control.

- *Oitzinger, 58 Mont. L.Rev. 420-21 (citing In re McLoon Oil Co.(Me.1989)*

And then there's the “usual” issues...

- Forecasted income (income approach)
- Reasonable market comps (market approach)
- Value of assets on balance sheet (net asset value approach)