REPLACING THE SWORD WITH A SCALPEL: THE CASE FOR A BRIGHT-LINE RULE DISALLOWING THE APPLICATION OF LACK OF MARKETABILITY DISCOUNTS IN SHAREHOLDER OPPRESSION CASES

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I. INTRODUCTION

When most of us hear the word "corporation," the large, public company whose stock is traded on "Wall Street" springs to mind. Often overlooked, but arguably much more important to the country's economy, are the small, closely held corporations that inhabit "Main Street."[1] The character of closely held corporations differs in numerous respects from that of public corporations.

Unlike public corporations, "close corporations" are typified by: "(1) a small number of stockholders; (2) no ready market for the corporate stock; and (3) substantial majority stockholder participation in the management, direction and operations of the corporation."[2] The combination of these characteristics, over time, often leads to conflict among the stockholders of close corporations.[3]

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1. Closely held corporations account for much of the business in the United States. Family-owned businesses alone represent ninety-five percent of all businesses and are responsible for close to fifty percent of the jobs in this country. *See* Douglas K. Moll, *Shareholder Oppression in Close Corporations: The Unanswered Question of Perspective*, 53 VAND. L. REV. 749, 754–55 (2000). President George W. Bush has described small businesses as "the backbone of our nation." Sonya Ross, *Bush Woos Small-Business Owners*, ARIZ. DAILY STAR, Feb. 7, 2001, at D1. Many "small businesses" are, of course, incorporated in order to take advantage of limited liability and other benefits of the corporate form.

2. Donahue v. Rodd Electrotype Co. of New England., 328 N.E.2d 505, 511 (Mass. 1975).

3. "Conflicts between the interests of the controlling and minority shareholders in stock corporations have been, and continue to be, a major—perhaps the single most important—problem in corporation law." J.A.C. Hetherington, *Defining the Scope of*

Occasionally, the majority stockholder or stockholders will take actions against a minority stockholder or a group of minority stockholders that a court deems oppressive. In such an instance, it is common for the court to order the corporation or one or more of the parties to buy out the other parties' interest in the corporation at its "fair value."[4] In their determination of what constitutes "fair value," courts have struggled with the decision of whether to apply a "lack of marketability discount" to reflect that there is no readily available market for the shares they are ordering to be bought out.[5]

Courts have disagreed about the appropriateness of discounting shares' value because of their illiquidity in the shareholder oppression context.[6] The most recent judicial approaches to this question have been to discourage the application of such discounts in most cases but provide discretion to judges to apply them when fairness and equity demand it.[7] This Note examines the various approaches courts have taken to the application of lack of marketability discounts in shareholder oppression cases and argues that allowing judges discretion in applying such discounts misconstrues their fundamental nature and invites abuse. Therefore, a bright-line rule limiting the applicability of such discounts in *all* cases is preferred to the current approaches.

This Note begins by explaining actions for shareholder oppression generally. Part II defines oppression, introduces involuntary dissolution statutes, and describes the most common alternative remedy to dissolution available to a court, a judicially ordered buyout. Part III discusses how courts go about valuing closely held corporations in buyout situations, focusing specifically on the concept of "fair value" and the applicability of various discounts. Part IV examines the jurisprudence surrounding the application of lack of marketability discounts in dissenters' rights litigation. The decisions in this area are relevant because they inform how courts treat such discounts in oppression actions. Part V of the Note tackles various state court decisions related to the application of lack of marketability discounts in judicially ordered buyouts pursuant to oppression actions. This section traces the historical progression of courts' decisions in this area and concludes by examining two recent cases, *Balsamides v. Protameen Chemicals, Inc.*[8] and *Advanced Communication Design, Inc. v. Follett*,[9] which

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Controlling Shareholders' Fiduciary Responsibilities, 22 WAKE FOREST L. REV. 9, 9 (1987).

4. *See, e.g.*, MODEL BUS. CORP. ACT § 14.34 (1991).

5. *See, e.g.*, Bobbie J. Hollis II, *The Unfairness of Applying Lack of Marketability Discounts to Determine Fair Value in Dissenters' Rights Cases*, 25 J. CORP. L. 137, 142 (1999).

6. *See, e.g.*, Balsamides v. Protameen Chemicals, Inc., 734 A.2d 721, 734–35 (N.J. 1999) (noting there is not a consensus about whether discounts should be applied in oppressed shareholder actions and jurisdictions are divided on the issue).

7. *See generally id.*; Advanced Communication Design, Inc. v. Follett, 615 N.W.2d 285 (Minn. 2000).

8. 734 A.2d 721.

9. 615 N.W.2d 285.

most accurately reflect the current policy regarding application of lack of marketability discounts. Part VI critiques the discretionary approaches taken by the New Jersey and Minnesota courts, outlining their potential shortcomings. The Note concludes by exposing the inappropriateness of allowing discretion in the application of discounts and explaining why a bright-line rule disallowing the application of lack of marketability discounts in all cases would be superior to the current approaches.

II. OPPRESSION ACTIONS GENERALLY

A. Defining Oppression

Majority rule and centralized control, the conventional norms of corporate law, can cause serious problems for minority shareholders in close corporations.[10] Most corporate power is traditionally centralized in the hands of a board of directors, and, in close corporations, the board is ordinarily controlled by the shareholder or shareholders holding a majority of the voting power.[11] Thus, the majority shareholders of a close corporation have the ability to take actions that are harmful to the minority shareholders' interests.[12] Such actions may be deemed "oppressive"[13] when they operate to "freeze-out" or "squeeze-out" minority shareholders.[14]

Majority shareholders can employ numerous techniques to freeze-out minority shareholders with whom they have a dispute. The majority may terminate a minority shareholder's employment, refuse to declare dividends, exclude the minority shareholder from participation in management, increase its own compensation in order to siphon off corporate earnings and reduce the minority's return, or use a combination of these tactics.[15]

Termination of employment may be a particularly hard hit for a minority shareholder in a close corporation. In contrast to public corporations, the earnings of a close corporation are usually distributed primarily in salaries, bonuses, and retirement benefits.[16] In addition, a close corporation job often carries with it significant benefits that are generally not available from other types of employment.[17] For example, salaries are generally higher for close corporation

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10. *See* Moll, *supra* note 1, at 757.

11. *See id.*

12. *See id.*

13. The standard for whether a particular action constitutes oppression varies from state to state. The standards range from finding oppression only when the majority had no rational business reason for its actions to finding oppression whenever the minority's expectations are frustrated. Most states' standards lie somewhere in between. *See generally* Moll, *supra* note 1, at 761–62.

14. *See id.* at 757.

15. *See id.* at 758.

16. *See id.*

17. *See id.* at 795.

shareholders than in comparable non-ownership positions.[18] Furthermore, close corporation shareholders generally hold high-level management positions, which are associated with higher salaries and levels of prestige.[19] Finally, numerous intangible benefits exist in owning a business and working for oneself.[20] Therefore, great harm may be inflicted on a minority shareholder whose employment is terminated, even if he or she is still receiving a proportionate share of the company's earnings.[21]

These peculiar characteristics of close corporations make minority shareholders vulnerable to majority abuse. Therefore, special laws to protect the value of a close corporation minority shareholder's investment are necessary. Involuntary dissolution statutes serve this purpose.[22]

B. Involuntary Dissolution Statutes

In a public corporation, the minority shareholder in disagreement with management policies can simply sell his or her shares on the open market.[23] In contrast, no market generally exists for the stock of a closely held corporation.[24] Therefore, close corporation minority shareholders at odds with the majority may be in the unenviable position of neither being able to protect their interests through a voice in management nor being able to reasonably withdraw their investments by selling their stock.[25] Such vulnerability provides incentives for majority shareholders to mistreat minority shareholders with the purpose of forcing them to sell their interests to the majority at unfairly low prices.[26]

This predicament precipitated the enactment of involuntary dissolution statutes in most states.[27] Section 14.30(2)(ii) of the Model Business Corporation Act (Model Act), for example, provides that a court may dissolve a corporation in a proceeding by a shareholder if "the directors or those in control of the corporation have acted, are acting, or will act in a manner that is illegal, *oppressive*, or fraudulent."[28] Similarly, the Model Statutory Close Corporation Supplement permits a shareholder to seek dissolution or some other remedy under the same circumstances, but clarifies that the shareholder may maintain a

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18. *See id.* at 795–96.
19. *See id.* at 796.
20. *See id.*
21. *See id.*
22. *See id.* at 792.
23. *See id.* at 759.
24. *See id.* For example, an IBM shareholder wishing to liquidate her investment can readily find other investors to purchase her shares at their fair value via the market facilitated by the New York Stock Exchange. By definition, no similar exchanges exist on which investors can trade shares of private, closely-held corporations.
25. *See id.* at 791.
26. *See id.* at 758.
27. *See id.* at 791–92.
28. MODEL BUS. CORP. ACT § 14.30(2)(ii) (1991) (emphasis added).

proceeding regardless of whether the actions were taken against him in his capacity as a shareholder, employee, or officer of the corporation.[29] Most states' judicial dissolution provisions are derived from or are similar to these model statutory codes.[30]

C. The Buyout Remedy for Oppression

Because dissolution of a corporation is a drastic step, both legislatures and courts have authorized alternative remedies for oppressive conduct that avoid actual dissolution.[31] The most common alternative remedy is for the corporation or one or more shareholders to buy out the interest of the complaining minority shareholder or shareholders,[32] though the complaining shareholder is given the right to buy out the oppressing majority shareholder in some states.[33]

Dissolution statutes based on the Model Act generally permit the corporation or one or more shareholders to elect to purchase the shares of the petitioning shareholder within a reasonable amount of time after the filing of the complaint.[34] Such an election stays the proceedings.[35] If the parties cannot reach an agreement, the court is charged with determining the fair value of the petitioner's shares.[36] Statutes based on the Close Corporation Supplement permit a court to order a buyout in an oppression action if other remedies are insufficient.[37] Even where a state's dissolution statute does not expressly provide for any remedy other than dissolution, however, "courts have often found the equitable power to fashion remedies not expressly created by the statute," including buyout.[38]

III. VALUATION AND THE CONCEPT OF FAIR VALUE

A. Determining "Fair Value"

Once a court has determined that a buyout is the appropriate remedy, a value must be placed on the portion of the corporation to be purchased. Both the Model Act and the Close Corporation Supplement instruct that "fair value" should be paid.[39] The majority of states follow this rule.[40] If the parties cannot reach an

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29. *See* MODEL STATUTORY CLOSE CORP. SUPPLEMENT § 40 (1991).

30. *See* Joshua M. Henderson, *Buyout Remedy for Oppressed Minority Shareholders*, 47 S.C. L. REV. 195, 199 (1995).

31. *See* Moll, *supra* note 1, at 792.

32. *See id.*

33. *See, e.g.*, N.J. STAT. ANN. 14 § A:12-7(c)(8) (West 2000).

34. *See* MODEL BUS. CORP. ACT § 14.34(a) (1991).

35. *See id.* § 14.34(d).

36. *See id.*

37. *See* MODEL STATUTORY CLOSE CORP. SUPPLEMENT § 42(a) (1991).

38. Henderson, *supra* note 30, at 214.

39. *See* MODEL BUS. CORP. ACT § 14.34(a) (1991); MODEL STATUTORY CLOSE CORP. SUPPLEMENT § 42(a) (1991).

agreement as to the "fair value" of the shares, the court must make its own determination.[41]

Determining the fair value of a shareholder's interest in a close corporation is a frustrating and daunting task for courts. Unlike public corporations, whose shares' value is set by the market, there generally is no market for shares of close corporations.[42] Indeed, courts and commentators have recognized that "fair value" is not synonymous with "fair market value."[43] Close corporations by their nature are less valuable to outsiders; however, their value may be significantly greater to those shareholders who want to keep the company in the form of a close corporation.[44]

The shareholder of a public corporation invests money with the expectation of receiving money in return.[45] That is, the investor expects only to receive a proportion of the earnings of the company, either in the form of dividends or appreciation in value of the stock. The close corporation investor, however, typically invests his capital with the expectation that his return will be comprised of a combination of employment benefits, management participation, and a share of the company's earnings.[46] Employment and management participation carry significant intangible benefits with them that, while potentially very valuable to the close corporation shareholder, defy objective measurement.[47] Consequently, "fair value" is an elusive target.

Generally courts have defined fair value in the context of a buyout as "the pro rata share of the corporation as a going concern."[48] In the context of valuation of shares in dissenters' rights cases, the American Law Institute (ALI) has defined fair value as "the value of the eligible holder's proportionate interest in the corporation, without any discount for minority status or, absent extraordinary circumstances, lack of marketability."[49] The ALI has approved of the application of this definition in the case of buyouts in oppression cases as well.[50]

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40. *See* John C. Coates IV, *"Fair Value" as an Avoidable Rule of Corporate Law: Minority Discounts in Conflict Transactions*, 147 U. PA. L. REV. 1251, 1260 n.27 (1999) (indicating that thirty-eight states have adopted this definition).

41. *See e.g.*, MODEL BUS. CORP. ACT § 14.34(d) (1991); MODEL STATUTORY CLOSE CORP. SUPPLEMENT § 42(b)(1) (1991).

42. *See* Hollis, *supra* note 5, at 140.

43. *See* Balsamides v. Protameen Chemicals, Inc., 734 A.2d 721, 733 (N.J. 1999); *see also* Hollis, *supra* note 5, at 141–42.

44. *See* Hollis, *supra* note 5, at 141.

45. *See* Moll, *supra* note 1, at 794.

46. *See id.*

47. *See id.* at 795–96.

48. Advanced Communication Design, Inc. v. Follett, 615 N.W.2d 285, 290 (Minn. 2000).

49. A.L.I., PRINCIPLES OF CORP. GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 7.22 (a) (1994).

50. *See id.* § 7.21 cmt. h.

While there is general consensus that "fair value" is the value of the oppressed shareholder's proportionate interest in the corporation as a going concern, rather than its liquidation value, valuing such interests is extremely problematic. Trial courts are generally granted a great deal of discretion in determining fair value, the sole caveat being that the techniques used must be ones that are generally accepted in the relevant financial community.[51] Such flexibility is mandated by the imperfection of financial theory for determining an entity's value absent a market,[52] the qualitative nature of value inherent in close corporations,[53] and the variety of characteristics unique to each company.[54] Indeed, the determination of fair value has often been described as "more an art than a science."[55] Proceedings to determine fair value often turn into a battle of experts, each of whom makes different financial assumptions and estimates and uses somewhat different valuation techniques.[56] Opposing experts often determine widely divergent values.[57] It is not unusual for the parties' respective experts to provide estimates that differ by a factor of ten.[58]

B. Discounts to Fair Value

Valuation of minority close corporation shares is further complicated by the question of whether to discount their value because of their minority and illiquid character. Because such discounts are often quite large, applying them can significantly reduce the value to be paid in a buyout.[59]

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51. *See Follett*, 615 N.W.2d at 290; *see also* Balsamides v. Protameen Chemicals, Inc., 734 A.2d 721, 734 (N.J. 1999).

52. *See, e.g.*, *Balsamides*, 734 A.2d at 730 ("[V]aluation of closely-held corporations is not an exact science."); Barry M. Wertheimer, *The Shareholders' Appraisal Remedy and How Courts Determine Fair Value*, 47 DUKE L.J. 613, 629 (1998) ("The valuation 'answer' given by each of [the different appraisal] techniques is very dependant on the assumptions underlying the calculations employed.").

53. *See, e.g.*, *supra* notes 45–47 and accompanying text.

54. *See, e.g.*, *Balsamides*, 734 A.2d at 729–30 ("[T]he valuation of closely-held corporations is inherently fact-based.").

55. *Id.* at 729; *see also* Wertheimer, *supra* note 52, at 629.

56. *See* Wertheimer, *supra* note 52, at 630 ("[B]oth parties to the appraisal proceeding will present expert testimony of valuation. Because of the inherent subjectivity and estimation involved, the parties' experts can compute dramatically different valuations, even if they utilize the same methodology.").

57. *See* John D. Emory, *The Role of Discounts in Determining "Fair Value" Under Wisconsin's Dissenters' Rights Statutes: The Case for Discounts*, 1995 WIS. L. REV. 1155, 1158 (1995).

58. *See* Wertheimer, *supra* note 52, at 631.

59. *See, e.g.*, McCauley v. Tom McCauley & Son, Inc., 724 P.2d 232, 243–44 (N.M. Ct. App. 1986) (allowing a 25% minority discount); *Balsamides*, 734 A.2d at 736 (finding a 35% discount for lack of marketability appropriate); Blake v. Blake Agency, Inc., 486 N.Y.S.2d 341, 349 (N.Y. App. Div. 1985) (reducing discount applied by trial court from 40% to 25% so that it only represented a discount for lack of marketability and not minority status).

1. Minority Discounts

A minority discount accounts for the fact that a minority interest, because it lacks the power to dictate corporate management and policies, is worth less to third-party purchasers than a controlling interest.[60] Most courts considering the issue have rejected the application of minority discounts in buyouts under dissolution proceedings.[61] Three primary rationales for the near universal rejection of minority discounts have been offered. First, some courts have reasoned that since a minority shareholder would receive his full, pro rata share of the corporation's net assets if dissolution was ordered, he should not be punished for the minority character of his shares in a buyout in lieu of dissolution.[62] A second reason for not applying minority discounts in a judicially ordered buyout is that when a majority shareholder purchases the minority shares, as happens in most cases, it is irrelevant that they represent a non-controlling interest because the party already possesses the power to control the corporation.[63] The third reason offered by some courts for rejecting minority discounts is that if majority shareholders elect a buyout in order to avoid dissolution, as many dissolution statutes permit, "the majority should not be allowed the benefit of a discount by making such an election."[64]

2. Lack of Marketability Discounts

A lack of marketability discount accounts for the fact that there is no ready market for the stock of closely held corporations.[65] This lack of a ready market makes it very difficult for a shareholder to liquidate his or her investment expeditiously.[66] Accordingly, a purchaser of such stock would demand a discount in order to account for such illiquidity.[67] This discount, or difference between what an outside investor would pay for the shares of a close corporation and the shares of an identical public corporation, is often called a lack of marketability discount.[68] The lack of marketability discount can be quite large; empirical studies indicate that it alone averages between thirty-five and fifty percent.[69]

Much less agreement exists among jurisdictions with regard to the applicability of lack of marketability discounts than to minority discounts.[70] The

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60. *See* Emory, *supra* note 57, at 1160.
61. *See* Henderson, *supra* note 30, at 226.
62. *See id.*
63. *See id.*
64. *Id.*
65. *See* Hollis, *supra* note 5, at 140.
66. *See id.*
67. *See* Emory, *supra* note 57, at 1161.
68. *See id.*
69. *See id.*
70. *See, e.g.*, Advanced Communication Design, Inc. v. Follett, 615 N.W.2d 285, 291 n.9 (Minn. 2000) (finding that almost all courts addressing fair value have

remainder of this Note addresses how the courts have treated lack of marketability discounts and argues that they should *never* be applied in buyouts pursuant to shareholder oppression cases.

IV. TREATMENT OF LACK OF MARKETABILITY DISCOUNTS IN DISSENTERS' RIGHTS CASES

In order to better understand the courts' reasoning in deciding whether to apply lack of marketability discounts in buyouts ordered under dissolution statutes, it is helpful to examine how courts have treated such discounts in buyouts pursuant to dissenters' rights cases.[71] The decisions in this area generally have followed one of three patterns: 1) allowing the application of lack of marketability discounts at the discretion of the trial court; 2) explicitly disallowing consideration of lack of marketability discounts in all cases; and 3) rejecting the application of such discounts except in extraordinary circumstances.[72]

A. Permitting Marketability Discounts

Numerous states, most notably New York and Illinois, permit the trial court, in its discretion, to apply lack of marketability discounts to the value of minority shares in dissenters' rights proceedings.[73] Underlying the reasoning in these jurisdictions is the implicit assumption that market value may be a component of fair value.[74] New York, for example, has explicitly stated that the objective in fixing fair value is to determine what a willing purchaser in an arm's length transaction would offer for the interest in the company as an operating business.[75] Essentially, courts adhering to this reasoning assume that the liquidity

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declined to apply minority discounts, but that courts have disagreed on whether to apply lack of marketability discounts).

71. Most states provide shareholders the opportunity to "dissent" from certain specified actions of a corporate board of directors and demand the corporation pay them "fair value" for their shares. These statutory rights are often called dissenters' rights or appraisal rights.

72. *See* Hollis, *supra* note 5, at 142–43.

73. *See* Quill v. Cathedral Corp., 627 N.Y.S.2d 157, 160 (N.Y. App. Div. 1995); *see also* Perlman v. Permonite Mfg. Co., 568 F. Supp. 222, 222 (N.D. Ind. 1983); WCM Indus., Inc. v. Trustees of the Harold G. Wilson 1985 Revocable Trust, 948 P.2d 36, 40 (Colo. Ct. App. 1997); Atl. States Constr., Inc. v. Beavers, 314 S.E.2d 245, 251 (Ga. Ct. App. 1984); Weigel Broad. Co. v. Smith, 682 N.E.2d 745, 750 (Ill. App. Ct. 1996); Ford v. Courier-Journal Job Printing Co., 639 S.W.2d 553, 556 (Ky. Ct. App. 1982); Robblee v. Robblee, 841 P.2d 1289, 1294–95 (Wash. Ct. App. 1992) (all holding that lack of marketability discounts may be applied in appraisal proceedings).

74. *See* Columbia Mgmt. Co. v. Wyss, 765 P.2d 207, 213 (Or. Ct. App. 1988).

75. *See* Blake v. Blake Agency, Inc., 486 N.Y.S.2d 341, 347 (N.Y. App. Div. 1985); *see also* *Quill*, 627 N.Y.S.2d at 159 (citing to *Blake's* reasoning for appraisal purposes in dissenters' rights cases).

risks inherent in closely held corporations affect majority and minority interests equally and, thus, can properly be considered in fixing fair value.[76]

Furthermore, these courts interpret their dissenters' rights statutes to vest them with significant discretion in applying discounts.[77] In general, a high value is placed in these states on granting trial courts the flexibility to craft financially equitable remedies.[78]

B. Rejecting Marketability Discounts in All Cases

A number of state courts have followed Delaware's lead in altogether disallowing the consideration of lack of marketability discounts in appraisals pursuant to dissenters' rights proceedings.[79] In *Cavalier Oil Corp. v. Harnett*, the Delaware Supreme Court concluded that the application of a lack of marketability discount to a minority shareholder is contrary to the statutory requirement that the company be viewed as a going concern.[80] The court reasoned, where no objective market value was present, the appraisal process is not intended to reconstruct a sale to a third party; rather, it assumes the shareholder was willing to maintain his investment position in the company had the event triggering the dissenters' rights not occurred.[81] Furthermore, according to the court, discounting individual shares injects into the appraisal process speculation about the factors affecting marketability.[82] Finally, the court feared that allowing lack of marketability discounts to be applied would provide incentive for majority shareholders to take actions that triggered dissenters' rights for the purpose of cashing out the dissenters at a price lower than their proportionate interest in the company as a going concern.[83] Doing so would, in effect, simply transfer wealth from minority shareholders to the majority and discourage minority shareholders from asserting dissenters' rights.[84] The majority of courts since *Cavalier Oil* have followed this rationale in rejecting the application of lack of marketability discounts in dissenters' rights proceedings.[85]

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76. *See* GLENN G. MORRIS & WENDELL H. HOLMES, 8 LA. CIV. L. TREATISE, BUSINESS ORGANIZATIONS § 38.08 (1999).

77. *See* Thomas J. Bamonte, *Should the Illinois Courts Care About Corporate Deadlock?*, 29 LOY. U. CHI. L.J. 625, 642 (1998).

78. *See id.*

79. *See* Hollis, *supra* note 5, at 142–43.

80. *See* Cavalier Oil Corp. v. Harnett, 564 A.2d 1137, 1144–45 (Del. 1989).

81. *See id.* at 1145

82. *See id.*

83. *See id.*

84. *See In re* Valuation of Common Stock of McLoon Oil Co., 565 A.2d 997, 1005 (Me. 1989).

85. *See* John J. Oitzinger, *Fair Price and Fair Play Under the Montana Business Corporation Act*, 58 MONT. L. REV. 407, 420 (1997) ("A majority of the courts conclude that no discounts should be taken in determining fair value...").

C. The American Law Institute Approach

The American Law Institute has followed the rationale of the Delaware courts in recommending that lack of marketability discounts not be considered in most cases.[86] The ALI, however, provides an exception that would allow courts to apply the discounts in "extraordinary circumstances."[87]

The extraordinary circumstances envisioned by the ALI require more than the absence of a trading market for the shares.[88] Rather, it suggests that courts apply this exception only when they find "that the dissenting shareholder has held out in order to exploit the transaction giving rise to appraisal so as to divert value to itself that could not be made available proportionately to other shareholders."[89] The ALI offers the following example of such a situation: a financially strained corporation with highly illiquid assets revises its charter to authorize a new class of preferred stock in order to raise the capital it needs to survive; this action triggers dissenters' rights under the applicable statute; and a shareholder who has been unsuccessful in persuading other shareholders to buy out his share takes advantage of the minor change solely to achieve liquidity and receive a significantly higher value for his shares than he would otherwise be able to attain in the market.[90] In such a situation, according to the ALI, there would be an unfair wealth transfer from the remaining shareholders to the dissenting shareholder.[91]

Due to the significant influence of the ALI's recommendations on corporate law, many recent cases in the area have followed this approach.[92] Some commentators, however, have criticized the exception contained in the ALI's approach for being prone to judicial abuse and misinterpretation and implicitly encouraging the use of the lack of marketability discount as a punitive measure.[93] An example of such a case is *Lawson Mardon Wheaton, Inc. v. Smith*,[94] decided by the New Jersey Supreme Court in 1999.

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86. *See* A.L.I. PRINCIPLES OF CORP. GOVERNANCE: ANALYSIS AND RECOMMENDATIONS, *supra* note 49, § 7.22(a).

87. *See id.*

88. *See id.* § 7.22, cmt. e.

89. *Id.*

90. *See id.*

91. *See id.*

92. *See, e.g.*, Lawson Mardon Wheaton, Inc. v. Smith, 734 A.2d 738, 749 (N.J. 1999):

> The history and policies behind dissenters' rights and appraisal statutes lead us to conclude that marketability discounts generally should not be applied when determining the "fair value" of dissenters' shares in a statutory appraisal action. Of course, there may be situations where equity compels another result. Those situations are best resolved by resort to the "extraordinary circumstances" exception in 2 ALI Principles ¶ 7.22(a).

93. *See* Hollis, *supra* note 5, at 155, 159.

94. 734 A.2d 738 (N.J. 1999).

In *Lawson Mardon Wheaton*, a family corporation instituted a business reorganization transaction in preparation for an initial public offering. Though the transaction was primarily cosmetic in nature, because it was accomplished in the form of a business combination, it triggered appraisal rights under New Jersey's dissenters' rights statute.[95] A group of shareholders, who desired to liquidate their interests in the corporation but were unable to due to a previous action of the board of directors restricting their ability to sell their shares outside of the family, exercised their dissenters' rights in order to force the company to buy them out at fair value.[96] The trial court determined that the dissenters "exploited a change they themselves championed and possibly prevented an IPO (initial public offering) to the detriment of other shareholders."[97] This, the court held, constituted an exceptional circumstance pursuant to the ALI's rule, warranting the application of a twenty-five percent marketability discount.[98] The Appellate Division deferred to the trial court's findings of fact and held that it had not abused its discretion in applying the discount.[99]

The New Jersey Supreme Court reversed, holding that the dissenters' actions did not fall within the "extraordinary circumstances" exception.[100] The court reasoned that most appraisal cases involving family-held corporations revolve around family feuds, and that a situation where dissenting shareholders desire to liquidate their investment in a company with whose management they have a dispute is an ordinary, rather than extraordinary, circumstance.[101] Rather than limit its opinion to a narrow interpretation of the extraordinary circumstances exception, however, the court went on to assert a broad principle that the equities of the case must be considered when ascertaining fair value.[102] The court laid down the following principle to guide future decisions: "a marketability discount cannot be used unfairly by controlling or oppressing shareholders to benefit themselves to the detriment of the minority or oppressed shareholders."[103]

Lawson Mardon Wheaton provides a clear illustration of why the extraordinary circumstances exception has been criticized. The case shows the difficulty of uniformly applying the extraordinary circumstances exception in practice. The trial court clearly applied the lack of marketability discount to penalize the dissenters for asserting their statutory rights. That the New Jersey Supreme Court found this to be an abuse of discretion proves that the exception is subject to abuse. While deciding that the circumstances of this case did not

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95. *See id.* at 741. For an explanation of appraisal rights and dissenters' rights, see *supra* note 71.

96. *See id.* at 741–42.

97. *Id.* at 744 (quoting trial court's ruling).

98. *See id.*

99. *See* Lawson Mardon Wheaton, Inc. v. Smith, 716 A.2d 550, 569 (N.J. Super. Ct. App. Div. 1998), *rev'd* 734 A.2d 738 (N.J. 1999).

100. *See Lawson Mardon Wheaton*, 734 A.2d at 749.

101. *See id.* at 750.

102. *See id.* at 752.

103. *Id.*

warrant the imposition of a lack of marketability discount, the court, by holding that the equities of each case must be considered in determining fair value, potentially encouraged trial judges to make judgments regarding shareholders' characters instead of simply making objective determinations of value.[104]

V. TREATMENT OF LACK OF MARKETABILITY DISCOUNTS IN DISSOLUTION CASES

A. Historical Development

The New Jersey Supreme Court's holding in *Lawson Mardon Wheaton* has ramifications for the application of lack of marketability discounts in oppression cases as well. The court signaled its intention to treat dissenters' rights cases and minority oppression cases similarly with respect to the application of illiquidity discounts.[105] This similar treatment is not limited to New Jersey; the dissenters' rights jurisprudence discussed in the previous section has also had an effect on how courts in other jurisdictions think about lack of marketability discounts with regard to oppression cases.

1. Cases Accepting Lack of Marketability Discounts

Only a few courts have directly addressed the application of lack of marketability discounts to buyouts in oppression cases. As one might anticipate, however, many of the courts that permit application of such discounts in dissenters' rights cases also generally accept their application in oppression cases.

New York courts' treatment of lack of marketability discounts provides a good example. In *Blake v. Blake Agency, Inc.*,[106] the founder of a storefront insurance brokerage firm died and left each of his four sons one-fourth of the company. Eventually, one of the sons acquired another one-quarter of the shares from one of his brothers and, thereby, was able to effectively control the company.[107] One of the remaining shareholder brothers claimed he had been frozen out of the corporation by the controlling brother because he was not consulted on important corporate decisions and had not received dividends.[108] Therefore, he petitioned the court to dissolve the corporation based on section 1104-a of New York's Business Corporations Law.[109] The corporation elected to purchase his shares for their fair value pursuant to section 1118(a).[110] Negotiations

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104. *See* Hollis, *supra* note 5, at 158–59.
105. *See Lawson Mardon Wheaton*, 734 A.2d at 752.
106. 486 N.Y.S.2d 341, 344 (N.Y. App. Div. 1985).
107. *See id.*
108. *See id.* at 344–45.
109. *See id.* at 345.
110. *See id.* Section 1118(a) reads:

> In any proceeding brought pursuant section eleven hundred four-a of this chapter, any other shareholder or shareholders or the corporation may, at any time within ninety days after the filing of such petition or at such

failed, however, and the court was forced to appoint a referee to help determine the fair value of the petitioner's shares.[111] The applicable New York law required the court to determine the fair value of the shares as of the day immediately preceding the day on which the dissolution petition was filed.[112] In valuing the petitioner's shares, the referee applied both minority and lack of marketability discounts.[113] On appeal, the Appellate Division rejected the application of the minority discount but approved of the application of a lack of marketability discount.[114]

The court defined fair value for purposes of oppression cases in the same way New York courts had in the dissolution setting: "The value of the corporation should be determined on the basis of what a willing purchaser, in an arm's length transaction, would offer for the corporation as an operating business, rather than as a business in the process of liquidation."[115] While it asserted that applying a minority discount would result in a windfall to the corporation, the court held that a discount for lack of marketability was appropriate because the shares of a closely held corporation cannot be readily sold on the public market.[116]

New York's highest court signaled its acceptance of this reasoning and approved of the application of lack of marketability discounts in valuation proceedings pursuant to dissolution cases in *Seagroatt Floral Company, Inc. v. Riccardi*.[117] Here, the court reaffirmed the *Blake* court's decision but expounded on its rationale. The court explained that once the corporation and majority shareholders elected to buy out the petitioner, any misconduct on their part that may have given rise to the proceedings became irrelevant.[118] The issue became solely one of valuation.[119] Furthermore, the court reasoned, because the relevant sections of New York's Business Corporation Law were enacted due, in part, to the fact there is generally no ready market for the shares of closely held corporations, any method of valuing an interest in a close corporation should include consideration of any risk associated with illiquidity of those shares.[120] Essentially, the New York courts' rationale in this area parallels their reasoning in appraisal cases: because a lack of marketability affects both majority and minority interests in close corporations similarly, it is appropriate to discount for it in determining fair value.

> later time as the court in its discretion may allow, elect to purchase the shares owned by the petitioners at their fair value and upon such terms and conditions as may be approved by the court.

111. *See Blake*, 486 N.Y.S.2d at 345.
112. *See id.*
113. *See id.*
114. *See id.* at 349.
115. *Id.* at 347.
116. *See id.* at 349.
117. 583 N.E.2d 287 (N.Y. 1991).
118. *See id.* at 290.
119. *See id.*
120. *See id.* at 290–91.

Jurisdictions permitting the application of discounts in buyouts pursuant to appraisal proceedings often cite the complexity of valuing shares in close corporations and grant trial courts significant discretion in determining fair value and applying discounts to account for illiquidity.[121] In *McCauley v. Tom McCauley & Son, Inc.*,[122] the Court of Appeals of New Mexico extended this rationale to buyouts pursuant to oppression cases as well.

In *McCauley*, a minority shareholder in a closely held family corporation was divorced from another shareholder. Her ex-husband, who controlled the corporation, succeeded in getting the corporation to oust her from the board of directors, remove her from her executive position, and deny her benefits other shareholders received.[123] The minority shareholder sued and the trial court found the corporation guilty of oppression.[124] As a remedy, the court offered the corporation three options: liquidation, partition and reorganization, or purchase of the minority shareholder's interest.[125] The corporation chose the third option, and, after a hearing, the court determined a "fair and reasonable" value for plaintiff's shares.[126] In doing so, the court applied a twenty-five percent discount to account for the fact that the "plaintiff's interest was that of a minority shareholder in a close family corporation."[127]

On appeal, the New Mexico Court of Appeals asserted that the trial court has great discretion in weighing the factors that determine the value of a close corporation's stock and, thus, upheld its application of a minority discount.[128] Though the discount at issue in this case was characterized as a minority discount, the court implied that its holding applies equally to lack of marketability discounts.[129] The court refused to establish a policy regarding the application of discounts in all cases; rather, it simply observed that arguments exist supporting the imposition of such discounts and that as long as evidence exists supporting their application in a particular case, a trial court's decision to do so will not be overturned.[130]

2. Cases Rejecting Lack of Marketability Discounts

While examples of courts expressly approving the application of lack of marketability discounts in buyouts pursuant to dissolution cases exist, the majority

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121. *See supra* text accompanying notes 73–78.

122. 724 P.2d 232 (N.M. Ct. App. 1986).

123. *See id.* at 235. Some of the benefits denied her included food, lodging, transportation, and medical insurance.

124. *See id.*

125. *See id.* at 243.

126. *See id.*

127. *Id.* at 244.

128. *See id.*

129. *See id.* ("Discount factors have often been utilized by courts to reflect the decreased value of shares in close corporations as opposed to publicly traded shares.").

130. *See id.*

rule of the more contemporary cases has been to reject their application in *most* circumstances.[131] One of the first state supreme court cases to do so was *Charland v. Country View Golf Club, Inc.*[132]

In *Charland*, the plaintiff, a fifteen percent shareholder in a closely held corporation, petitioned the court for dissolution based on the allegation that one of the officers of the corporation was engaging in illegal activities.[133] The corporation elected to purchase Charland's shares pursuant to Rhode Island's Model Act based statute,[134] which permitted the corporation or one of the other shareholders to elect to purchase the shares of the petitioner at their fair value in order to avoid dissolution.[135] The parties could not agree on a price, so the trial court, pursuant to the statute, appointed an appraiser to determine the fair value of Charland's shares "as of the close of business on the day on which the petition for dissolution was filed."[136] In his determination of fair value of Charland's shares, the appraiser applied a discount to account for the minority status and lack of marketability of the shares.[137]

On appeal, the Rhode Island Supreme Court held that application of either minority or lack of marketability discounts is improper in buyouts pursuant to dissolution proceedings.[138] With regard to lack of marketability discounts, the court distinguished its holding from the New York court's holding in *Blake* by pointing out the differing language of the states' respective statutes. New York's statute required a court to determine fair value as of the close of the business day *before* the petition for dissolution was filed, while Rhode Island's statute required valuation as of the day *on which* the petition for dissolution was filed.[139] The court found the fact that the Rhode Island statute specifically allowed for consideration of the filing of the petition to be significant.[140] The court went further, however, and declared that, even without regard to the discrepancy between the Rhode Island and New York statutes, it believed that application of lack of marketability discounts in buyouts pursuant to dissolution proceedings was inappropriate.[141] The court reasoned that a minority shareholder seeking dissolution is claiming that the majority engaged in unfair conduct and that, if the company was ultimately dissolved, all shareholders would receive their pro rata share of the company's assets regardless of the illiquid nature of their shares.[142] Therefore, concluded the

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131. *See, e.g.*, Advanced Communication Design, Inc. v. Follett, 615 N.W.2d 285, 291 (Minn. 2000).
132. 588 A.2d 609 (R.I. 1991).
133. *See id.* at 609.
134. R.I. GEN. LAWS § 7-1.1-90.1 (1985).
135. *See id.*
136. *Charland*, 588 A.2d at 610.
137. *See id.* at 610 n.4.
138. *See id.* at 612–13.
139. *See id.* at 612.
140. *See id.*
141. *See id.* at 613.
142. *See id.*

court, minority shareholders should not receive less than this value if, instead of challenging the dissolution action, the majority elects to buy out the minority and avoid the possibility of dissolution.[143]

Other courts have followed similar rationale in rejecting the applicability of marketability discounts in cases involving oppression. In *Chiles v. Robertson*,[144] the Oregon Court of Appeals upheld a trial court's decision not to impose a lack of marketability discount in a case involving breach of fiduciary duty and oppression by the majority.[145] The court stressed that the trial court's order for the defendants to buy out the plaintiffs' shares was a judicial remedy designed to compensate the plaintiffs for damages resulting from the defendants' wrongs and, therefore, should not be treated as if it was a market transaction.[146] The court further justified its opinion by pointing out that if the discounts were applied, the plaintiffs would receive less than they would upon dissolution, a result the court found inappropriate in light of the defendants' oppressive conduct.[147]

The Oregon Court of Appeals reaffirmed this rationale in 2000. *Cooke v. Fresh Express Foods Corp.*[148] involved a family corporation in which the majority froze out a minority shareholder after his divorce from one of the controlling shareholders.[149] The minority shareholder sued for breach of fiduciary duty and oppression.[150] Oregon law allows a court, upon a finding of oppression, to order the dissolution of the corporation[151] or, in the alternative, to award a less drastic remedy, including requiring the majority to buy out the minority's interest at fair value.[152] In this case, the trial court found the majority's conduct to be oppressive and ordered it to purchase the plaintiff's shares at a price that did not reflect a discount for illiquidity.[153] Citing *Chiles*, the appellate court approved of the trial court's decision, noting that the application of discounts was inappropriate because the defendants were ordered to purchase the plaintiff's shares as a remedy for their misconduct.[154]

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143. *See id.*

144. 767 P.2d 903 (Or. Ct. App. 1989).

145. *See id.* at 926. The oppressive conduct the court found in *Chiles* resulted from a conflict of interest of the majority shareholders that caused them to fail to negotiate as vigorously in favor of the corporations as their fiduciary duties to the minority shareholders required.

146. *See id.*

147. *See id.*

148. 7 P.3d 717 (Or. Ct. App. 2000).

149. *See id.* at 719–21.

150. *See id.* at 721.

151. *See* OR. REV. STAT. § 60.661 (1987).

152. *See Cooke*, 7 P.3d at 722.

153. *See id.* at 724–25.

154. *See id.* at 725 ("[B]ecause defendants must purchase plaintiff's shares as a remedy for their misconduct, and the price for plaintiff's shares is therefore based on their fair value rather than their fair market value, either a minority or marketability discount would be inappropriate.").

Washington's Court of Appeals, in an unpublished 1997 opinion, also weighed in against the application of lack of marketability discounts in cases where there has been a finding of oppression.[155] In *Prentiss v. Wesspur, Inc.*, the fifty-one percent shareholder of an arboculture equipment business took actions to freeze out the forty-nine percent shareholder after various disagreements between the two.[156] The minority shareholder sued to recover the fair value of his shares.[157] The trial court found that the majority shareholder had frozen out the minority shareholder, making the minority shareholder equivalent to a dissenting shareholder and entitling him to the fair value of his shares.[158] Under these circumstances, the trial court reasoned, neither a minority nor lack of marketability discount was appropriate.[159]

The appeals court affirmed the trial court's decision.[160] The court noted that "fair value" is the value of the shares at the time immediately preceding the majority's misconduct.[161] This value, the court asserted, "should fully compensate the shareholder forced out, and avoid giving a windfall to the party committing misconduct."[162] The court relied, in part, on the trial court's declaration that the plaintiff stood in a similar position as a shareholder in a dissenters' rights action.[163] Therefore, the court opined, the numerous reasons cited by courts for disallowing lack of marketability discounts in dissenters' rights cases were equally applicable to dissolution cases.[164] The court went further, however, asserting that "cases involving dissolution provide an even stronger reason to refuse a marketability discount."[165] Whether by dissolution or the majority owner's purchase, the court reasoned, the minority shareholder is not selling on the market and should not be subject to a discount for lack of marketability when it is the majority's misconduct that precipitated the transaction to begin with.[166]

The reasoning employed by the various state courts for not applying lack of marketability discounts in dissolution actions was summarized effectively in a recent federal case, *McKesson Corp. v. The Islamic Republic of Iran*.[167] *McKesson* involved an action against Iran for improper expropriation of corporate assets under international law. The court recognized, however, that the position of the foreign shareholder in the face of an expropriating government is analogous to that

155. *See* Prentiss v. Wesspur, Inc., No. 93-2-02129-8, 1997 WL 207971 (Wash. Ct. App. Apr. 28, 1997).
156. *See id.* at *1.
157. *See id.*
158. *See id. at *2.*
159. *See id.*
160. *See id.* at *1.
161. *See id.*
162. *Id.*
163. *See id.* at *2.
164. *See id.*
165. *Id.*
166. *See id.*
167. 116 F. Supp. 2d 13 (D.D.C. 2000).

of the oppressed or forced-out minority shareholder in a close corporation and, thus, analyzed the case under the same principles.[168]

The D.C. District Court observed that other courts have held discounts to be inherently unfair in forced-sale situations because the forced-out shareholder did not pick the timing of the transaction and, thus, is not in the position of a willing seller.[169] Furthermore, the court noted, because allowing discounts creates incentives for oppressive behavior, they are disfavored where a shareholder is forced to sell as a result of such behavior.[170] Consequently, the court refused to allow the application of either a minority or lack of marketability discount in this situation.[171]

B. Contemporary Developments

Two recent decisions from the highest courts of New Jersey[172] and Minnesota[173] provide the most detailed analysis to date of the application of lack of marketability discounts in shareholder oppression cases. The cases, though advocating somewhat different standards, take positions that represent a compromise between those cases generally accepting the use of lack of marketability discounts and those clearly rejecting them.

1. New Jersey's Approach

Balsamides v. Protameen Chemicals, Inc. involved a dispute between two fifty-percent shareholders.[174] In 1997, Emanuel Balsamides, Sr., and Leonard M. Perle teamed up to start Protameen Chemicals, a company supplying chemicals to the cosmetics industry.[175] Balsamides handled sales, advertising, marketing, and insurance, while Perle was responsible for the technical and administrative sides of the business.[176] The company grew to be very successful. By mid-1995, it had gross sales in excess of $19 million and each of the shareholders maintained annual incomes exceeding $1 million.[177]

Trouble between the two shareholders started in the late 1980s, when both owners' sons were brought into the business.[178] Balsamides brought his sons

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168. *See id.* at 37.
169. *See id.*
170. *See id.*
171. *See id.*
172. *See* Balsamides v. Protameen Chemicals, Inc., 734 A.2d 721 (N.J. 1999).
173. *See* Advanced Communication Design, Inc. v. Follett, 615 N.W.2d 285 (Minn. 2000).
174. *See* 734 A.2d 721, 722.
175. *See id.*
176. *See id.*
177. *See id.*
178. *See id.*

in as salesmen.[179] Perle, on the other hand, started his sons in administrative and office management positions, his area of expertise.[180] Perle believed that his sons should receive the same compensation as Balsamides's sons.[181] Because salesmen worked on commission, were given expense accounts, and received company cars, however, Balsamides's sons earned substantially more than Perle's.[182] This disparity caused acrimony and hostility between the families.[183] In his quest for parity for his sons, Perle engaged in numerous activities designed to undermine the Balsamideses and to improve the opportunities for his sons at the expense of the company and Balsamides.[184]

In 1995, Balsamides sued for dissolution under New Jersey's oppression statute.[185] After a nineteen day trial, the trial court found that Balsamides was an oppressed shareholder under N.J. Stat. Ann. § 14A:12-7, ordered Perle to sell his interest in the company to Balsamides for $1,960,500, and assessed punitive damages of $75,000 against Perle.[186] The court determined that requiring Perle to sell to Balsamides was the most fair and equitable solution because Perle had been more at fault, Balsamides was the one primarily responsible for the company's dynamic growth, and most members of the cosmetics industry associated Balsamides, not Perle, with Protameen.[187] In determining fair value of Perle's interest, the court relied on the testimony of Balsamides's expert, who applied a

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179. *See id.*
180. *See id.* at 723.
181. *See id.*
182. *See id.* at 722–23.
183. *See id.* at 723 ("Conditions at Protameen deteriorated to the point where both sides compared the judicial separation as a 'divorce,' and one described the blood feud in which they were engaged as a 'reenactment of the Hatfields and the McCoys.'").
184. *See id.* at 724. Specifically, the court found that Perle purposefully refused or delayed in providing technical information required for the Balsamideses' customers, refused to provide product samples when requested by the plaintiffs' customers, refused to stock inventory that he knew plaintiffs' customers would be ordering, assented to his son Adam's sale of a product in Florida in violation of Protameen's distribution agreement with one of the company's major customers, denied plaintiffs access to the company's computer system, and treated plaintiffs disparagingly in front of the company's employees.
185. *See id.* at 723.
186. *See id.* at 723–26. N.J. STAT. ANN. § 14A:12-7(c)(8) provides in relevant part:

> Upon motion of the corporation or any shareholder who is a party to the proceeding, the court may order the sale of all shares of the corporation's stock held by any other shareholder who is a party to the proceeding to either the corporation or the moving shareholder or shareholders, whichever is specified in the motion, if the court determines in its discretion that such an order would be fair and equitable to all parties under all circumstances of the case. (a) The purchase price of any shares so sold shall be their fair value as of the date of the commencement of the action or such earlier or later date deemed equitable by the court, plus or minus any adjustments deemed equitable by the court....

187. *See Balsamides*, 734 A.2d at 724–25.

thirty-five percent lack of marketability discount.[188] In doing so, the court explicitly rejected the analysis of Perle's expert, who did not apply a lack of marketability discount.[189] The court reasoned that the goal of valuation was to determine the intrinsic, or market, value of the business, not the value in light of a court ordered buyout.[190]

The Appellate Division disagreed that a lack of marketability discount should have been applied under these circumstances and remanded the matter to the trial court for reconsideration of the valuation of Perle's interest.[191] The appellate court did not dispute the usefulness of a lack of marketability discount in general, but rather held that its application was not appropriate in a sale from one co-equal owner to another.[192] The court distinguished this situation from one where there is sale of stock to the general public or where Balsamides bought an interest in the company with the possibility that it might result in the later sale of a partial interest to a member of the public.[193]

Balsamides appealed to the New Jersey Supreme Court, which, in a decision issued the same day as *Lawson Mardon Wheaton*, reversed the Appellate Division's decision and upheld the trial court's application of the lack of marketability discount.[194] The court held that it would be unfair, under the circumstances, to require Balsamides to pay an undiscounted amount for Perle's shares.[195]

The court began its analysis by observing that fair value should mean the same in oppression actions as it does in dissenters' rights cases.[196] The court next noted, as it had in *Lawson Mardon Wheaton*, that "fair value" is not synonymous with fair market value, "there is no inflexible test for determining fair value," and that "an assessment of fair value requires proof of value by any techniques or methods generally accepted in the financial community."[197] The court suggested that discounting the value of the entire corporation may be appropriate if it is a generally accepted method of valuing businesses in the financial community.[198]

The court next examined its decision in *Lawson Mardon Wheaton* and the existing jurisprudence surrounding lack of marketability discounts in oppression cases. The court pointed out that, in *Lawson Mardon Wheaton*, it had found most persuasive those cases holding that lack of marketability discounts should generally not be applied when determining the fair value of a dissenter's shares in

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188. *See id.* at 725.
189. *See id.*
190. *See id.*
191. *See id.* at 726.
192. *See id.*
193. *See id.*
194. *See id.* at 738.
195. *See id.*
196. *See id.* at 733.
197. *Id.* at 733–34.
198. *See id.* at 733.

an appraisal action, but recognized that there may be situations where equity compels a different result.[199] The court next examined the decisions of other courts regarding the application of discounts in oppression actions, recognizing that, although the jurisdictions are divided, the majority of those addressing the issue have rejected the use of lack of marketability discounts.[200]

The court interpreted its dissolution statute, however, to grant substantial discretion to courts to adjust fair value.[201] The statute provides that the purchase price in a judicially ordered buyout shall be a "fair value . . . deemed equitable by the court, plus or minus any adjustments deemed equitable by the court."[202] Accordingly, the court held that in deciding whether to apply a marketability discount to determine the fair value of shares in a judicially ordered buyout, courts must take into account what is fair and equitable.[203]

Next, the court disputed the Appellate Division's assumption that the company would not later be sold.[204] The court found this assumption erroneous and the fact that the buyer was already designated irrelevant because Balsamides would be buying a company that would remain illiquid and would be worth less to potential outside purchasers because of its closely-held nature.[205] The court hypothesized that if Perle and Balsamides sold Protameen together, the price they could demand would reflect the company's illiquidity and both partners would share that detriment.[206] Similarly, the court pointed out, were Balsamides to pay Perle a discounted price, they would also share in the lack of marketability discount: Perle would suffer his half of the markdown immediately, while Balsamides would suffer the other half when he eventually sold the business.[207] Conversely, the court noted, were Balsamides required to pay Perle an undiscounted price, he would suffer the full effect of Protameen's lack of marketability at the time he eventually sold the company.[208] Therefore, the court held that to not apply a lack of marketability discount would be unfair, particularly because Perle was the oppressor and the equities of the case clearly lied with Balsamides.[209]

The court regretted that it could not pronounce a consistent rule regarding the application of discounts under various circumstances; but it felt it could not do so because "[e]ach decision depends not only on the specific facts of the case, but

199. *See id.* at 734.
200. *See id.* at 734–35.
201. *See id.* at 735.
202. N.J. STAT. ANN. § 14A:12-7(8)(a) (West 2002).
203. *See id.* at 735.
204. *See id.*
205. *See id.*
206. *See id.* at 735–36.
207. *See id.*
208. *See id.*
209. *See id.* at 736.

also should reflect the purpose served by the law in that context."[210] It justified the different outcomes in this case and *Lawson Mardon Wheaton* under this principle, asserting that the application of the equities in the two cases dictated opposite results.[211] In *Lawson Mardon Wheaton*, it was the corporation that approved a restructuring plan that triggered dissenters' rights and the corporation that was purchasing the minority shareholders' interests.[212] To allow the majority to buy out the minority dissenters at a discount under these circumstances, the court asserted, would penalize the minority for exercising its statutory rights, provide the majority incentive to engage in activities to create dissent, and encourage the majority to dispose of troublesome shareholders while simultaneously allowing them to profit.[213] The court, however, acknowledged the possibility that minority shareholders might occasionally manipulate corporate activity to gain unfair advantage. In this case, the court explained, principles of equity would enable the court to determine fair value accordingly.[214]

The court differentiated cases such as *Balsamides*, where the oppressing shareholder instigates the problems. In these cases, the court asserted, fairness dictates that the oppressing shareholder should not benefit at the expense of the oppressed.[215] Allowing Perle to receive an undiscounted price for his stock, the court explained, would penalize Balsamides and reward Perle.[216] The court refused to decide "the harder question" of what to do when it is the oppressing shareholder who is given the buyout option.[217] The court concluded by stating the guiding principle it purported to apply in both cases: "a marketability discount cannot be used unfairly by the controlling or oppressing shareholders to benefit themselves to the detriment of the minority or oppressed shareholders."[218]

2. Minnesota's Approach

Advanced Communication Design, Inc. v. Follett[219] addressed "the harder question" that the New Jersey Supreme Court declined to answer in *Balsamides*: whether to apply a lack of marketability discount when an oppressing shareholder is ordered to buy out the oppressed shareholder.[220] The case involved a dispute between a one-third owner of a closely held corporation and the husband and wife in control.[221] Marco Scibora founded Advanced Communication Design (ACD), a company engaged in the business of voicemail and integrated voice response

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210. *Id.* at 737.
211. *See id.*
212. *See id.*
213. *See id.* at 738.
214. *See id.*
215. *See id.*
216. *See id.*
217. *Id.*
218. *Id.*
219. 615 N.W.2d 285 (Minn. 2000).
220. *See id.* at 292.
221. *See id.* at 287–88.

systems, in 1986.[222] Brian Follett joined the company in 1988.[223] In 1990, Follett and another employee, Stein, each purchased 1500 shares of class B nonvoting stock in ACD. This resulted in Scibora, Follett, and Stein each owning one-third of the company, but with Scibora owning all of the class A voting stock.[224] In 1994, the three shareholders entered into a buy-sell agreement that included a provision permitting the corporation to, within ninety days, exercise an option to purchase the shares of any shareholder whose employment was terminated for reasons other than disability or death.[225] The agreement further provided that if the parties could not agree on a purchase price, the value of the shares would be determined by a financial firm called Exponential or its successor.[226]

In 1995, Stein terminated his employment and sold his nonvoting shares to the corporation for $50,000.[227] Stein was paid an additional $45,000 in severance and for a noncompete agreement.[228] At the time, Scibora informed Follett of the $50,000 purchase price of Stein's stock but not of the additional $45,000 payment.[229] In January 1996, Scibora appointed his wife (F. Scibora) Chief Operating Officer of ACD, positioning her as Follett's supervisor.[230] F. Scibora's employment agreement provided that she was to be paid a salary of $20,000 and given 1500 shares of nonvoting stock in a restricted stock award.[231] Follett was not informed of the restricted stock award to F. Scibora.[232] Follett's relationship with Scibora subsequently deteriorated and, in October 1996, Scibora demoted Follett from his position of vice-president and reduced his salary.[233] Follett then submitted a proposal for a severance package, but when no agreement could be reached, he resigned, retaining his stock.[234]

ACD subsequently sued Follett for breach of fiduciary duty as a shareholder and sought to prevent him from further soliciting ACD customers.[235] Follett filed a counterclaim against ACD and Scibora, alleging that the Sciboras had acted in an unfairly prejudicial manner towards him and requesting that the court either dissolve the corporation or provide other equitable relief.[236] In February 1997, ACD exercised its option to repurchase Follett's shares pursuant to the buy-sell agreement and offered Follett $24,646.[237] When Follett declined, ACD sought an appraisal from a company called Chartwell Financial, since Exponential no longer performed such appraisals.[238] Chartwell appraised the shares at $30,000, and ACD amended its complaint requesting that the court require Follett to sell his shares at this value pursuant to the buy-sell agreement.[239]

In January 1998, the court ordered another appraisal of Follett's shares, this time by a three-member panel consisting of an appraiser appointed by each party and one appointed by the court.[240] Follett's appraiser and the one appointed by the court issued a majority opinion determining ACD's enterprise value to be

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222. *See id.* at 287.
223. *See id.*
224. *See id.*
225. *See id.*
226. *See id.*

$1,426,143 and, thus, appraising Follett's one-third share at $475,381.[241] To this value, however, the appraisers applied a fifty-five percent lack of marketability discount, thus valuing the shares at $213, 921.[242] ACD's appraiser, Chartwell, issued a minority opinion valuing ACD at $875,000. After applying a seventy-five percent minority discount and a thirty-five percent lack of marketability discount, Chartwell determined the value of Follett's shares to be $46,665.[243]

The trial was held in May 1998.[244] The trial court dismissed ACD's breach of fiduciary duty claim against Follett.[245] It further found that Scibora had acted in bad faith by failing to disclose the terms of Stein's severance agreement, not offering Follett an opportunity to purchase some or all of Stein's stock, not informing Follett that F. Scibora would receive stock in the company, and failing to follow the procedures in the buy-sell agreement by offering to purchase the stock at an unfairly low price and seeking an appraisal from a company other than Exponential.[246] The court found these actions to be unfairly prejudicial to Follett and ordered Scibora and ACD to purchase Follett's shares for fair value.[247]

In setting fair value, the trial court adopted the three-member panel's majority appraisal, but refused to apply the lack of marketability discount.[248] The court reasoned that while the discount may be appropriate in a sale to a third party, this was a court-ordered sale to a corporation whose only remaining shareholders

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227. *See id.*
228. *See id.*
229. *See id.*
230. *See id.*
231. *See id.*
232. *See id.*
233. *See id.*
234. *See id.* at 287–88.
235. *See id.* at 288.
236. *See id.* MINN. STAT. § 302A.751 (1998) allows a court, in the case of unfair prejudicial treatment of a shareholder or shareholders of a closely held corporation by those in control of the corporation, to grant any equitable relief it deems just and reasonable in the circumstances or to dissolve the corporation. The statute further permits the court, upon petition by the corporation or any shareholder, to order a buyout if it determines that it would be fair and equitable to all the parties under all of the circumstances. *See id.* at 289–90.
237. *See id.* at 288.
238. *See id.*
239. *See id.*
240. *See id.*
241. *See id.*
242. *See id.*
243. *See id.*
244. *See id.*
245. *See id.*
246. *See id.* at 289.
247. *See id.*
248. *See id.*

had acted in an oppressive manner towards the selling shareholder.[249] Under these circumstances, the court concluded, applying a lack of marketability discount would interfere with statutory purposes of protecting minority shareholders and ensuring that court-ordered buyouts be fair and equitable to all parties.[250]

The court of appeals affirmed.[251] Citing New Jersey's decisions in *Balsamides* and *Lawson Mardon Wheaton*, the appellate court agreed that a lack of marketability discount was inappropriate because it would allow the controlling shareholders to benefit at the expense of an oppressed minority shareholder.[252]

Minnesota's Supreme Court reversed and remanded the case, ordering the trial court to apply a lack of marketability discount.[253] The court first examined Minnesota's dissolution statute and determined that the legislature had intended to grant courts broad flexibility in fashioning remedies under it that are fair and equitable, including ordering a buyout at fair value.[254] Next, the court addressed the meaning of "fair value" under Minnesota's Business Corporations Act[255], concluding that it means "the pro rata share of the value of the corporation as a going concern."[256] It pointed out that a court may rely on proof of value by any technique that is generally accepted in the relevant financial community and should consider all relevant factors in determining fair value, but made it clear that "the value must be fair and equitable to all parties."[257]

The court then moved on to a discussion of lack of marketability discounts. After examining the treatment of the discount in other jurisdictions, paying particular attention to the Rhode Island Supreme Court's decision in *Charland* and the New Jersey Supreme Court's decision in *Balsamides*, the court determined that Minnesota's statutory scheme was clearly intended to provide courts "maximum flexibility to fashion a remedy 'fair and equitable to all parties'" and, thus, a bright-line rule was inappropriate.[258] The court reasoned that while a rule that permitted majority shareholders to reap a windfall by buying out dissenting shareholders at a discount or encouraged corporate squeeze-outs would be contrary to the statutory purpose of providing a remedy to minority shareholders, a bright-line rule that would foreclose consideration of lack of marketability discounts under all circumstances would sometimes lead to

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249. *See id.*
250. *See id.*
251. *See id.*
252. *See id.*
253. *See id.* at 293.
254. *See id.* at 289–90 ("If the court determines that ordering a buy-out is fair and equitable to all parties under the circumstances, it also has broad discretion both in the process and the ultimate determination of the 'fair value' of the shares to be sold.").
255. MINN. STAT. § 302A.751 (1998).
256. *Follett*, 615 N.W.2d at 290.
257. *Id.*
258. *Id.* at 292 (quoting Minnesota's dissolution statute).

valuations that were unfair to the remaining shareholders.[259] The court found this result contrary to the statute's directive that remedies be "fair and equitable to all parties."[260]

In order to provide some direction for trial courts, the Minnesota Supreme Court adopted the extraordinary circumstances exception that the ALI had recommended be applied in dissenters' rights cases.[261] The court believed a bright-line rule disallowing lack of marketability discounts in all cases would hamper courts' ability to take into account circumstances that would lead to an unfair wealth transfer if the discount were not applied.[262] Therefore, the court established the following rule: "absent extraordinary circumstances, fair value in a court-ordered buy-out pursuant to section 302A.751 means a pro rata share of the value of the corporation as a going concern without discount for lack of marketability."[263]

In order to provide guidance to the lower courts, the court listed a number of factors relevant to fair value to be taken into account in order to achieve maximum flexibility in the application of the extraordinary circumstances exception to avoid an unfair wealth transfer. The court suggested the following be considered:

> whether the buying or selling shareholder has acted in a manner that is unfairly oppressive to the other or has reduced the value of the corporation, whether the oppressed shareholder has additional remedies...or whether any condition of the buy-out, including price, would be unfair to the remaining shareholders because it would be unduly burdensome on the corporation.[264]

In considering these factors, the court stressed, "the overarching policy however, is to ensure the buy-out is 'fair and equitable to all parties.'"[265]

Applying these factors to the case at hand, the court concluded that not applying a lack of marketability discount would be clearly unfair to the remaining shareholders, Mr. and Mrs. Scibora.[266] The court pointed out that the value placed on Follett's interest in the corporation absent the discount, $475,381, was more than five times the total net worth of the company, almost seven times its average annual operating cash flow over the preceding five years, and more than eight times its average net income over the same period.[267] Requiring ACD or Scibora to pay the undiscounted value of Follett's shares, the court asserted, would represent

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259. *See id.* at 292.
260. *Id.*
261. *See id.*
262. *See id.*
263. *Id.*
264. *Id.* at 292–93.
265. *Id.* at 293 (quoting MINN. STAT. § 302A.751).
266. *See id.*
267. *See id.*

an unfair wealth transfer from the remaining shareholders to Follett because it would place unrealistic financial demands on the corporation and likely strip the company of the cash flow and earnings necessary for future growth.[268] This, the court held, represented an extraordinary circumstance requiring the application of a lack of marketability discount.[269]

VI. AN ANALYSIS OF THE "FAIR AND EQUITABLE" APPROACHES

Balsamides and *Follett* provide the most detailed analysis to date of the policy considerations surrounding the decision of whether or not to apply lack of marketability discounts in court-ordered buyouts in oppression cases. Because of their thoughtful analysis, one or both of their approaches are likely to be followed by other courts in the future. Therefore, a closer look at these approaches is warranted.

A. New Jersey's Approach: What Is Fair and Equitable Under the Circumstances?

The *Balsamides* Court interpreted New Jersey's dissolution statute to vest significant discretion in the trial court to determine the fair value of the shares to be purchased.[270] In deciding whether to apply a lack of marketability discount in the determination of fair value, the state's high court directed that the trial court should consider what is fair and equitable under the circumstances of each case.[271] To guide the trial courts in this pursuit, the court laid down the rule that a lack of marketability discount cannot be used by the oppressing shareholders to benefit themselves to the detriment of the oppressed shareholders.[272]

Stated this way, the rule seems to be an admirable proclamation of an intent to protect minority shareholders. It may implicitly convey a different intent, however, when the rule is reversed. In other words, would the court also support the logical converse of the statement: that a lack of marketability discount *can be* used to benefit the oppressed to the detriment of the oppressor? If so, the court is advocating the application of lack of marketability discounts as a punitive measure.

The result in *Balsamides* bears this out. The court's reasoning appeared to be directed at the more common situation where the oppressor is the purchaser and

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268. *See id.* The court further explained: "Respondent thus receives a value for his stock based on the past growth of the corporation, but the remaining shareholders are left with stock in a corporation that has extremely doubtful potential for growth." *Id.*

269. *See id.* The court remanded the matter to the trial court with directions to apply a lack of marketability discount of between thirty-five percent and fifty-five percent. *See id.*

270. *See* Balsamides v. Protameen Chemicals, Inc., 734 A.2d 721, 735 (N.J. 1999).

271. *See id.*

272. *See id.* at 738.

would receive a windfall if allowed to purchase the oppressed shareholder's shares at a discount. In this case, however, the court ordered Perle, the oppressor, to sell his stock.[273] Forcing Perles to sell his shares to Balsamides at a marketability discount thus did not benefit the oppressor, it penalized him.[274] This seemed to be exactly what the court intended, though.[275]

The one-sided nature of New Jersey's rule regarding lack of marketability discounts becomes even clearer when *Balsamides* is compared to the court's decision in *Lawson Mardon Wheaton.* Despite the court's assertions that the different results were warranted by the differing "equities" of the cases and the differences between dissenters' rights and oppression cases, it is relatively clear that it was the identity of the buyers that made the difference. Indeed, the court applied precisely the same standard in each case.[276] Even though the court professed to not be answering the "harder question" of what to do when it is the oppressing shareholder who is the buyer, there is little doubt how the court would come out on the issue given the standard it enunciated.

B. Minnesota's Approach: What Is Fair and Equitable to All Parties?

In *Advanced Communication Design v. Follett*, the Minnesota Supreme Court interpreted its dissolution statute to vest trial courts with broad discretion and flexibility in fashioning remedies.[277] When ordering a buyout, the court directed trial courts to determine a value that is fair and equitable to all parties.[278] Because these discounts often allow oppressing shareholders to reap a windfall and encourage corporate squeeze-outs, the court ordered that lack of marketability discounts be applied only in extraordinary circumstances.[279] Extraordinary circumstances would exist, according to the court, when there would be an unfair

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273. *See id.* at 724.

274. The court's assertion that Balsamides, as the sole surviving shareholder, would bear the same discount as that of Perle, the shareholder whose interest was purchased, is troubling. It certainly may be an oversimplification, because sole ownership of an enterprise is more easily marketable than a partial interest. *See* Vincent E. Gentile, *New Jersey Supreme Court Rules on Marketability Discounts in Valuation Cases*, N.J. LAW. 9, 11 (Dec. 1999). Additionally, the court chastises the Appellate Division's assumption that the company would not later be sold by Balsamides and, in fact, bases its analysis on the assumption that he would sell the company in the future. *See Balsamides*, 734 A.2d at 735–36. This may not be a proper assumption. The objective value of a company is dependant, in part, on who owns it. Therefore, when determining the value of an entity at any one point in time, the valuator must hold the ownership structure constant. Since "fair value" assumes the company is a going concern, it seems logical to also assume that the owner or owners are not contemplating selling it.

275. *See* JEFFREY D. BAUMAN, ET AL., CORPORATIONS LAW AND POLICY: MATERIALS AND PROBLEMS 35 (4th ed. Supp. 2000).

276. *See Balsamides*, 734 A.2d at 737.

277. *See* 615 N.W.2d 285, 292 (Minn. 2000).

278. *See id.*

279. *See id.*

wealth transfer were a discount not applied.[280] As guidance for the lower courts, the court outlined a number of factors to be considered in connection with applying the extraordinary circumstances exception, including whether there has been oppression or harm done to the corporation, whether additional remedies are available to the oppressed shareholder, and whether the price, absent a marketability discount, would be unfair to the other shareholders because it would be unduly burdensome on the corporation.[281]

The Minnesota court's approach is much more logical and defensible than the New Jersey Supreme Court's position because the effect of the trial court's determination of fair value on *all* parties is considered. The approach seems especially appropriate in the situation where there are other shareholders present who are not involved in the litigation. In such an instance, the court's concern about not placing the corporation in a position that could jeopardize its future success seems especially appealing.

The primary problem with the Minnesota court's approach, however, lies in its application. The court applied the extraordinary circumstances exception suggested by the ALI for dissenters' rights cases to oppression cases.[282] The unfair wealth transfer situation envisioned in the dissenters' rights situation is not really analogous to oppression cases, though. In the dissenters' rights situation, the exception is applied to prevent dissenting shareholders from taking advantage of the other shareholders; it is implicitly assumed that there is some impropriety involved in the assertion of dissenter's rights in some situations. Though it would be naïve to assume that the oppressed minority shareholder is completely blameless in most situations,[283] it is difficult to assert that he or she would be doing something improper by seeking relief under an oppression statute designed to protect minority shareholders.

Furthermore, the term "unfair wealth transfer" is not self-defining; it still calls for the subjective judgment of a court. Therefore, it becomes easy to imagine judges justifiably reaching opposite opinions regarding the application of lack of marketability discounts in identical cases. In *Advanced Communication Design v. Follett*, the Minnesota Supreme Court based its determination that extraordinary circumstances existed on the fact that the undiscounted price was more than five times the company's net worth, nearly seven times its average annual cash flow, and more than eight times the average net income.[284] These multiples by themselves, however, tell little about the impact having to purchase Follett's shares would have on the company's future prospects. The issue is much more complicated, and the numbers provided in a company's financial statements, in

280. *See id.*
281. *See id.* at 292–93.
282. *See id.* at 292.
283. *See* Gentile, *supra* note 274, at 11 (pointing out that in corporate divorce actions, "no one is likely to be blameless, and each side is likely to have engaged in conduct that can later be deemed unfair by a court").
284. *See Follett*, 615 N.W.2d at 293.

been correct in its evaluation of the effect the buyout would have in this case; however, it is difficult to say that judges as a group are qualified to make this determination.

Finally, if whether a lack of marketability discount is applied hinges not on the propriety of any actions taken by the oppressed shareholder, but, rather, on the numbers on a company's balance sheet, income statement, and cash flow statement, then otherwise similarly situated shareholders could be awarded vastly different prices for their shares. Imagine two shareholders in different companies with identical enterprise values, who have been oppressed in exactly the same manner and to the exact same degree. Under the Minnesota court's application of the extraordinary circumstances exception, one may receive up to fifty-five percent less money for his shares than the other simply because his company's income and cash flows have been smaller than the other company's in the past. This cannot be considered "fair and equitable." Even if different values are warranted by equitable considerations, though, a lack of marketability discount is an inappropriate means of achieving such equity.

VII. The Superiority of a Bright Line Rule

The New Jersey and Minnesota courts interpret their respective statutory schemes to require courts to consider fairness and equity when setting "fair value."[285] Given the difficulties of valuing closely held corporations, the many subjective components of value in such corporations, and the numerous complexities and unique circumstances surrounding each corporate divorce, providing courts with such discretion may well be the best alternative. Leaving it to trial courts to determine whether applying a lack of marketability discount is fair and equitable under the circumstances surrounding each case, however, is a misuse of this discretionary doctrine. A bright-line rule disallowing the application of discounts in all cases has many advantages.

A. The Inappropriateness of Using Discounts as a Discretionary Tool

Allowing judges to use a lack of marketability discount as a tool to penalize oppressors or to adjust value to a "fair" level is akin to asking a surgeon to operate with a sword instead of a scalpel. Like a sword, a lack of marketability discount may cut both too deep and too wide.

Lack of marketability discounts make poor equity-achieving tools because they are often quite large. Applying such discounts may result in the undercompensation of close corporation shareholders, whose return includes salary and other perquisites as well as a share of profits.[286] Furthermore, when used as punitive devices they can be especially harsh. The percentage discount applied by

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285. *See supra* Part V.B.

286. *See* Bamonte, *supra* note 77, at 642 (suggesting that this may provide powerful disincentive to oppressed shareholders to assert their statutory rights).

used as punitive devices they can be especially harsh. The percentage discount applied by a court appointed appraiser or expert witness may or may not bear any nexus to the magnitude of the wrongs perpetrated by the oppressing shareholder. If the goal of fixing a "fair value" is to determine a price that represents the value in the eye of the oppressed shareholder, while simultaneously balancing considerations such as the harm done, the policy goals of deterrence, and the effect on remaining shareholders, indiscriminately applying a discount of twenty-five to fifty-five percent seems especially arbitrary.

At the same time, lack of marketability discounts are too coarse a tool because they obscure courts' reasoning for deciding that a particular value is fair. Other equitable remedies are available that would allow courts to follow statutory requirements that the buyout prices be fair and equitable without using lack of marketability discounts as a mechanism to achieve this goal. In the case where a court desires to penalize oppressors or to discourage oppressive behavior, punitive damages are available. For example, the trial court in *Balsamides* did award punitive damages of $75,000.[287] This illustrates that trial courts are perfectly capable of compensating oppressed shareholders for the wrongful acts of their oppressors without incorporating such considerations into determinations of fair value.[288]

In situations like that in *Advanced Communication Design v. Follett*, where the buyout price would place unreasonable demands on the corporation and adversely affect the remaining shareholders, the question becomes more difficult. While using a lack of marketability discount to adjust the price is not any more defensible in this situation, the alternative means courts may utilize to adjust prices to fit their visions of "fairness" may be as equally arbitrary. Such situations may, however, force courts to be more forthright about their underlying reasoning in deciding that a particular value is most fair and equitable, rather than allowing them to obscure their true motivations by cloaking them in a lack of marketability discount.

Despite the courts' treatment of them otherwise, lack of marketability discounts are really objective elements of financial valuation theory.[289] This suggests that they should either always be applied, or never, depending on a court's interpretation of the meaning of "fair value." When lack of marketability

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287. *See* Balsamides v. Protameen Chemicals, Inc., 734 A.2d 721, 725–26 (N.J. 1999).

288. *See generally* Hollis, *supra* note 5, at 159 (asserting that "[f]air value should measure the price, not the person" and criticizing the ALI's extraordinary circumstances exception in dissenters' rights cases as implicitly advocating use of a lack of marketability discount as a punitive measure).

289. *See, e.g.*, Gentile, *supra* note 274, at 9 (asserting, with regard to the New Jersey Supreme Court's decisions in *Balsamides* and *Lawson Mardon Wheaton*, "that application of a marketability discount is not just a matter of economic theory or valuation methodology but, rather, something that will depend on what [the court considers to be] fair and equitable under the circumstances").

discounts are permitted to be used simply as a tool that can be manipulated in whatever way deemed necessary to achieve "fair" results, the rule encourages judicial insincerity.

In addition to helping to prevent shareholder undercompensation and oppressor over-penalization and promoting judicial sincerity in determinations of fair value, a bright-line rule offers another advantage as well—certainty. Predicting whether a court will consider a lack of marketability discount fair and equitable under the circumstances of a particular case will often be difficult, if not impossible.[290] Such uncertainty may cause many negative consequences. Paramount among these is the possibility that shareholders will avoid asserting their statutory rights for risk of being undercompensated,[291] or that majority shareholders accused of oppression will be reluctant to pursue a vigorous defense for risk of being over-penalized. In addition, the certainty provided by a bright-line rule will allow the shareholders of close corporations to more easily bargain around the standard in shareholder's agreements and other contracts, thus obviating the need for judicial intervention.[292]

B. On Which Side of the Line Should the Rule Fall?: The Argument Against Lack of Marketability Discounts

It is not enough to agree that a bright-line rule is superior; courts must also decide which side of the line the rule should fall. As this Note has illustrated, the majority of courts and commentators agree that lack of marketability discounts generally should not be applied in buyouts pursuant to oppression cases.[293] Discounts often provide majority shareholders with a windfall when they or the corporation are ordered to purchase the oppressed minority shareholder's interest, the most common situation.[294] Discounts provide majority shareholders incentive to freeze-out minority shareholders in such situations as well.[295] Even in the unusual situation where the oppressed shareholder is permitted to buy out his oppressor, lack of marketability discounts can be improperly punitive.[296] Therefore, the weight of reason supports a rule that falls on the side of the bright line forbidding the application of lack of marketability discounts in all cases.

VIII. CONCLUSION

Courts have only recently given detailed attention to the application of lack of marketability discounts to determine fair value in judicially-ordered buyouts pursuant to shareholder oppression suits. The rules that have emerged

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290. *See id.*
291. *See* Bamonte, *supra* note 77, at 642–43.
292. *See id.* at 643.
293. *See supra* Part V.
294. *See supra* Part V.A.2.
295. *See supra* Part V.A.2.
296. *See supra* Part VI.A.

generally discourage the application of such discounts in most cases, but provide discretion to judges to apply them when fairness and equity seem to demand it. These discretionary exceptions misconstrue the fundamental nature of discounts and almost ensure abuse. Like a surgeon operating with a sword instead of a scalpel, utilizing lack of marketability discounts as tools to achieve "fair and equitable" results achieves too much and not enough at the same time. Because of their inherently large nature, lack of marketability discounts are not tools that can be effectively manipulated to achieve equitable purposes. At the same time, they allow courts to obscure their true intentions under the guise of applying an objective valuation technique. A bright-line rule disallowing the application of lack of marketability discounts in all cases would be superior to the current regime. While a bright-line rule may not simplify courts' difficult task of determining "fair value," it will force courts to be more sincere about why they consider a particular value to be "fair."