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FCG VALUATION CASE E-FLASH

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Dorothy Dawkins, Plaintiff v. Hickman Family Corporation and Perry Hickman, Defendants
United States District Court for the Northern District of Mississippi Eastern Division
Cause No. 1:09-CV-164, Judge: Hon. Sharion Aycock, June 13, 2011

In a Mississippi oppressed shareholder case, the court determined the fair value of shares of Hickman Family Corporation (the "Company" or "HFC"). The court also dismissed the petition for dissolution filed by the plaintiffs after allowing the Company and its shareholders to purchase the dissenting shareholders' interests at fair value.

TAKEAWAY
This case is not particularly significant in terms of issues commonly addressed in statutory fair value cases (e.g., application of discounts for lack of control or lack of marketability). Instead, its significance lies in the court's recognition of the business appraiser's presentation and how his work product affected the decision making process.

Fully informing a court with supportable opinions and evidence will benefit the court and may result in a ruling favorable to the supported evidence.

THE FACTS
In June 2009, the Plaintiff filed a Verified Complaint for Dissolution and Temporary and Preliminary Injunctive Relief against the Company. The Complaint also named Perry Hickman in his capacity as HFC's Chairman and General Manager. In October 2009, pursuant to a move for dismissal filed by Mr. Hickman, the Court dismissed the Complaint against Mr. Hickman as Chairman and General Manager. However, because he filed a Notice of Election to Purchase Shares on July 28, 2009, Mr. Hickman remained party to the current action.

After the Notice of Election was filed with the Court, four other shareholders intervened in the dissolution action – seeking to dissolve the Company – and were named as plaintiffs. In August 2009, Mr. Hickman filed an Amended Notice of Election to Purchase Shares of all of petitioners. Three days after his Amended Notice was filed, Mr. Hickman filed a motion requesting determination of the fair value of the plaintiffs' shares, to order the sale of the shares, to stay the proceedings, and to enter a final judgment.

In response, one plaintiff filed a Motion for Summary Judgment, which requested dissolution of the Company. A second plaintiff filed a Response to the Motion for Summary Judgment, which was another request to dissolve HFC.

In November, the Court denied the plaintiffs' requests for summary judgment and granted Mr. Hickman's request to stay the dissolution of the Company. Because the plaintiffs were mostly proceeding pro se, the Court allowed them forty-five days to retain a real estate appraiser and business valuation expert. At the end of the 45 days, the plaintiffs had "failed to file anything with the Court" (emphasis in original).

The only valuation evidence provided at trial was provided by the Defendants.

DISCUSSION

Mississippi grants the Court the power to dissolve a corporation if the shareholders establish that the directors have acted in an illegal, oppressive, or fraudulent manner. Further, it offers the corporation or remaining shareholders the ability to buy out the other shareholders at fair value in lieu of dissolution.[1] The Court indicated many other states offer similar protection.[2]

The opinion particularly noted that determination of fair value of closely-held stock is fact-dependent and that no single formula can be used.

The Plaintiffs provided no evidence of the fair value of their interests to the Court. In particular, the Court faulted the Plaintiffs for failing to take advantage of the additional 45 days to retain an expert. In contrast, the Defendants retained an independent business valuation expert ("Expert"). The Court accepted the Expert's extensive report and commended his thorough review.

Expert began his report by describing HFC and noting that as a farm, the Company's value lies in its assets. Even though the assignment was not for federal statutory or fair market value purposes, the Expert followed the guidelines set forth in Revenue Ruling 59-60. He also considered three approaches to value commonly considered in business valuation: asset, income, and market. Because HFC's value lies in its underlying assets, the Expert gave no further consideration to the income approach. Citing the Fifth Circuit decision in Dunn v. Commissioner, 301, F.3d 339, 350 (5th Cir. 2002), the Court also accepted the Expert's contention that the market approach was not appropriate.

Because neither the income nor market approaches produced a meaningful value and because the Company was an asset-holding company, Expert relied upon the net asset value method under the asset approach. Noting guidelines set forth in R.R. 59-60, the Court accepted the Expert's methodology.

Although the Plaintiffs challenged the Expert's conclusion, they did not question the methods and approaches used. Accordingly, the Court determined that the Plaintiffs "appear to concede that this asset-based methodology is correct."

However, the Plaintiffs claimed the Expert made two errors. First, Plaintiffs alleged that Expert should have determined the value of the Petitioner's 35.7% interest, not the corporation's 100% value. Second, Plaintiffs alleged the Expert should not have adjusted the farm's value by the potential built-in gain tax liability associated with the sale of entity assets.

The Court dismissed the first error, noting that the value of a 35.7% interest in the Company could be determined by multiplying 0.357 by the 100% value. It should be noted that the Court did not discuss levels of value or that the subject interests were required to be valued without discounts for lack of marketability or lack of control. If the interests should have been discounted, the Court's conclusion would be incorrect.

The Court disagreed with the second assertion and accepted the built-in gains tax liability dollar-for-dollar. "The corporation cannot realize the fair market value of the assets without incurring this tax liability." The Court again cited Dunn 301 F.3d at 351 when accepting the dollar-for-dollar built-in gains tax liability of an asset-based methodology.

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[1] The Court cited the Official Comment to Section 14.34 of the Model Business Corporation Act – which Mississippi adopted when it passed the Mississippi Business Corporation Act. "Commentators have observed that it is rarely necessary to dissolve the corporation and liquidate its assets in order to provide relief: the rights of the petitioning shareholder are fully protected by liquidating only the petitioner's interest and paying the fair value of his or her shares while permitting the remaining shareholders to continue the business. In fact, it appears that most dissolution proceedings result in a buyout of one or another of the disputants' shares …" Model Business Corporation Act § 14.34 Official Comment.

[2] Twenty one other states offer corporations or its shareholders the ability to buy out petitioning shareholders at fair value in order to avoid dissolution, including Alabama, Alaska, Arizona, California, Connecticut, Florida, Illinois, Maine, Maryland, Michigan, Missouri, Montana, New Hampshire, New Jersey, North Carolina, North Dakota, South Carolina, Vermont, West Virginia, Wisconsin, and Wyoming.

Ultimately, the Court accepted the Defendants' value of the subject interests and dismissed the Complaint for Dissolution. In lieu of dissolving HFC, Mr. Hickman was required to purchase the shares at the determined fair value.

CONCLUSION

In a refreshingly simple case from a business valuation perspective, the Defendants prevailed by fully informing the Court. In particular, the Court was impressed by the thorough review performed by the Expert and "the detailed description of business valuation methodology" provided by the Expert.

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