Kentucky Joins the Modern Rule Against Marketability Discounts in Dissenter Rights Actions

Since 1982, Kentucky law has supported the position that a discount for minority may be applied in determining the "fair value" of shares held by a dissenting shareholder. *Ford v. Courier-Journal Job Printing Co., Inc.*, 639 S.W.2d 553 (Ky. App. 1982). The tide began to turn against that analytic path over 2009-2010 wherein a pair of opinions from the Court of Appeals rejected discounts, requiring rather that the dissenting shareholder receive their full pro-rata value of the corporation as a going concern. *Brooks v. Brooks Furniture Mfgrs., Inc*., 325 S.W.3d 904 (Ky. App. 2010); *Shawnee Telecom v. Brown*, No. 2008-CA-00042-MR & No. 2008-CA-000167-MR, 2009 WL 2475269 (Ky. App. Aug. 14, 2009) (not to be published). While the *Ford* opinion may as of its time have been consistent with then accepted views, it has fallen victim to time as a broad range of statutes, courts and commentators have come to the view that permitting minority discounts to be imposed on dissenting shareholders provides an opportunity for windfall to the controlling shareholders. *See* Thomas E. Rutledge and David Lester, *Fair Value With or Without Discounts: Are the Rules Changing in Dissenter Rights Actions?* 6 The Kentucky CPA Journal 28 (2010).

On October 27, the Kentucky Supreme Court has brought Kentucky law current with the now broadly accepted standard as to valuation in a dissenter rights action, decisively rejecting minority discounts. *Shawnee Telecom v. Kathy Brown*, No. 2009-SC-000574-DG (Ky. Oct. 27, 2011).

Writing in the context of a dissenter rights action, the Kentucky Supreme Court wrote that:

> [W]e conclude that "fair value" is the shareholder's proportionate interest in the value of the company as a whole and as a going concern…. As for applying a marketability discount when valuing the dissenter's shares, we join the majority of jurisdictions which, as a matter of law, reject this shareholder level discount because it is premised on fair *market* value principles which overlook the primary purpose of the dissenter's appraisal rights – the right to receive the value of their stock in the company as a going concern, not its value at a hypothetical sale to a corporate outsider. Slip op. at 2.

In the course of the opinion, the court expressly addressed the prior *Ford* decision, writing that it "does not accurately address 'fair value' and should be overruled in its entirely." Slip op. at 18. Continuing in the same vein, the Supreme Court wrote:

> We hold, in sum, that in a KRS 271B.13 appraisal proceeding the dissenting shareholder is entitled to the fair value of his or her shares as measured by the proportionate interest those shares represent in the value of the company as a going concern, a value determined in accord with the general accepted valuation concepts and techniques and without shareholder–level discounts for lack of control or marketability. Slip op. at 33.

And as well observed:

> Once the entire company has been valued as a going concern, however, by applying an appraisal technique that passes judicial muster, the dissenting shareholder's interest may not be discounted to reflect either a lack of control or a lack of marketability. Slip op. at 44.

Net Asset Value is a Viable Methodology

In the *Shawnee* case, Brown, the dissenting shareholder, asserted that net asset value should not have been utilized in determining the company's value, a view in turn approved by the Kentucky Court of Appeals. The Kentucky Supreme Court did not, however, agree with that assessment. Rather, it wrote that net asset value is an accepted approach to business valuation that may be utilized by an appraiser to establish the market value of the subject company. Slip op. at 37. The important point is, however, that the net asset value must be used as part of an approach to determine the market value of a company on a going concern basis and not merely the liquidation value of its tangible assets. Slip op. at 38, footnote 8.

Entity Level Discounts Remain Possible

The Court held that entity level discounts, based upon the particular facts and authorities applicable to the specific company under consideration, may be appropriate. For example, the court acknowledged that it may be appropriate to apply a marketability discount to determine the value of the company as contrasted with the value of an otherwise similar publicly traded venture. The Court listed other entity level discounts that may, in a particular circumstance, be appropriate as including the key manager, limited customer/supplier base, "trapped-in" capital gains, environmental liabilities, pending litigation, portfolio and a small size. Slip op. at 40. On these points, the Court cited Business Valuation Discounts and Premiums by Shannon D. Pratt.

Valuation Remains an Art

The proper weighting of the market, the net asset value and capitalized earnings as well as other appropriate is a question within the expertise of the valuation professional retained on the engagement. While minority discounts, at the shareholder level, may no longer be appropriate, the full range of the art of valuation otherwise remains viable in dissenter rights actions.

This Decision Addresses Valuation in the Context of a Dissenters Rights Case and Not Otherwise

The Supreme Court made clear there may exist different standards for valuation to be applied in different circumstances. It did this in face of assertions by Shawnee and the Kentucky Chamber of Commerce (it filed an amicus brief in this case) to the effect that the "fair value" standard of the dissenter rights cases should be applied consistently with the fair market standards applied in marital dissolution and tax cases. The Court rejected that suggestion, noting that the dissenter rights statute has a particular purpose, namely protecting the economic interest of the minority shareholders, and for that purpose fair value was used in place of market value. Hence, the use of various discount factors to determine fair *market* value in other contexts is not impaired by this ruling. Slip op. at 36.

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