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Application of Minority and Marketability Discounts in Appraisal Actions Under Missouri Revised Statutes Section 351.455

Swope v. Siegel-Robert, Inc.¹

I. INTRODUCTION

Appraisal statutes are available to provide fair compensation to minority shareholders of corporations who are squeezed out against their will. Missouri Revised Statutes Section 351.455, the Missouri statute that provides for appraisal rights in the event of a merger or consolidation, requires corporations to pay dissenting minority shareholders “fair value” for their shares.² The Missouri appraisal statute does not define “fair value,” nor does it provide a mathematical formula for determining the value of dissenters’ shares.³ Rather, Missouri case law has established that courts are to consider all relevant facts and circumstances to determine the value of a dissenter’s shares.⁴ A significant question of law is whether minority and marketability discounts should be applied.⁵ The various state courts are divided as to the appropriateness of both

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3. See id.
4. See Phelps v. Watson-Stillman Co., 293 S.W.2d 429, 433 (Mo. 1956) (“Every relevant fact and circumstance which enters into the value of the corporate property and which reflects itself in the worth of corporate stock [should be considered].”) (quoting Norman D. Lattin, Remedies of Dissenting Stockholders under Appraisal Statutes, 45 Harv. L. Rev. 233, 262 (1931)); Dreiseszun v. FLM Industries, Inc., 577 S.W.2d 902, 907 (Mo. Ct. App. 1979) (quoting Phelps, 293 S.W.2d at 433).
5. See Swope, 243 F.3d at 491. Application of a minority discount in the appraisal of a corporation is meant to account for the lack of control inherent in minority shares. See Richard A. Booth, Minority Discounts and Control Premiums in Appraisal Proceedings, 57 BUS. LAW. 127, 131 (2001). The rationale is that because a minority shareholder who is squeezed out has no real say in how the corporation was run before being squeezed out, and because shareholders who buy enough shares to gain control of the company often pay a premium (known as a control premium), discounting for lack of control avoids giving minority shareholders a windfall in the appraisal process. See id. (“[T]he term minority discount as properly understood refers to a discount from the price that would be set for non-control shares in an active market simply because they are minority shares and have no power to influence the governance of the corporation and may therefore be exposed to the possibility of looting.”). Application of a marketability discount accounts for the illiquidity of shares of a close corporation. Id. Because the shares are not liquid, an investor would not pay full value for the shares in an arms-length transaction, and, thus, the squeezed-out shareholder’s interest in the company is worth
discounts. Although the Missouri Supreme Court has not yet decided the issues, in *Swope v. Seigel-Robert, Inc.*, the United States Court of Appeals for the Eighth Circuit predicted that the Missouri high court would reject both discounts. Although the Eighth Circuit was probably right in rejecting a marketability discount, it may have been wrong in concluding that the Missouri Supreme Court would reject a minority discount.

II. FACTS AND HOLDING

Siegell-Robert, Inc., a closely-held Missouri corporation ("Company"), was formed in 1946 by Bruce Robert as a part-time chrome-plating business. Beginning in the 1980s, the Company experienced a great deal of growth through an aggressive program of acquiring manufacturing companies. On July 19, 1997, Halvor B. Anderson, Siegel-Robert's Chief Executive Operating Officer, proposed a cash out merger that would allow the Company to make less than the pro rata value of the company. *See id.* ("[A] marketability discount refers to a discount from what a fair trading price would be if there were an active market for the shares.").

7. *Id.* at 489.

9. *Swope*, 243 F.3d at 489. Anderson became the Company's Chief Executive Operating Officer in October 1996, after working his way up through the company ranks during a fifteen-year tenure of employment. *Id.*

10. Merger statutes that allow cash to be given to shareholders in consideration for their stock in a merger explicitly allow majority shareholders to force out minority shareholders via a merger of the corporation with a shell corporation. Elliott J. Weiss, *The Law of Take Out Mergers: A Historical Perspective, 56 N.Y.U. L. Rev. 624, 624 (1981).* Such a squeeze-out can be accomplished as follows: [A] majority can transfer its shares in a corporation to a shell corporation and then cause the original corporation to be merged into the shell with all the current shareholders of the original corporation exchanging their shares for cash. After the minority is paid off, the shell corporation, which is wholly owned by the original corporation's majority shareholders, owns the original corporation's business.
an S corporation election in order to avoid taxation at both the corporate and shareholder levels.\textsuperscript{11} On July 21, the board of directors voted to recommend the merger to the shareholders, and Anderson mailed a notice of vote to the shareholders on the same day.\textsuperscript{12} On July 31, the required majority of shareholders approved the proposed merger at a shareholders meeting called to consider the merger.\textsuperscript{13} Siegel-Robert, Inc., a Missouri corporation, was then merged into Siegel-Robert, Inc., a Nevada corporation, which was the surviving corporation.\textsuperscript{14}

Anderson valued the shares of the minority shareholders who were squeezed out of Siegel-Robert as a result of the merger at twenty dollars per share, taking into consideration the lack of a market for the stock, the fact that the Company had traditionally repurchased shares for sixty-five percent below book value, the expectation that income for the shares for the next year would decrease, and historical dividend figures.\textsuperscript{15} In its opinion, the United States Court of Appeals for the Eighth Circuit noted that Anderson:


\textsuperscript{11} \textit{Swope}, 243 F.3d at 489. Corporate taxes for 1997 were $41 million, while corporate taxes for 1998 were projected to be only $5 million as a result of the Company’s S corporation election. \textit{Swope}, 74 F. Supp. 2d at 885. In order to qualify for S corporation status, a corporation must, among other things, have no more than seventy-five shareholders. \textit{Swope}, 243 F.3d at 489; \textit{see also} I.R.C. § 1361(b)(1)(A) (2000). When Anderson proposed the merger, the Company had sixty-three shareholders; forty were family members of Bruce Robert, the Company’s founder, representing ownership of ninety-three percent of the Company’s stock, and twenty-three were non-family members, representing ownership of seven percent of Company stock. \textit{Swope}, 74 F. Supp. 2d at 879 n.3. Although the number of Company shareholders was already within the maximum number allowable for an S corporation, the Company felt that the merger would guarantee that the number of shareholders would not grow too large in the future. \textit{See Swope}, 243 F.3d at 489. In addition, having non-family shareholders would increase the risk of "re-opening the tax issue," because a unanimous vote of shareholders was required for the Company to make an S corporation election. \textit{Id.; see also} I.R.C. § 1362(a)(2) (2000). Anderson admitted that the Company’s S corporation status could have been protected by amending the by-laws to disallow the sale of shares in such a manner that would jeopardize the Company’s S corporation election, but the Company nevertheless opted to cash out the non-family shareholders. \textit{Swope}, 243 F.3d at 489.

\textsuperscript{12} \textit{Id.}

\textsuperscript{13} \textit{Id.} at 490.

\textsuperscript{14} \textit{Id.}

\textsuperscript{15} \textit{Id.}

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[D]id not consult the Board of Directors, an appraiser, an evaluation professional, an accountant, a member of senior management, or any family or non-family members, nor did he consider appointing a committee to determine a fair value or to explore whether there was a duty to protect the interests of minority shareholders.\textsuperscript{16}

At the shareholders meeting on July 31, 1997, a majority of non-family shareholders voted against the merger and requested that Anderson reconsider the twenty dollar share price and hire an appraiser.\textsuperscript{17} Anderson declined and the merger was approved.\textsuperscript{18} Eleven of the non-family shareholders accepted the twenty dollar offer, but the others made a written demand on the Company for a higher price for their stock.\textsuperscript{19} When the Company refused to increase its offer, some of the minority shareholders filed suit in federal district court under Missouri Revised Statutes Section 351.455, requesting fair value for their stock.\textsuperscript{20}

\begin{itemize}
\item \textsuperscript{16} \textit{Id.} Anderson had extensive experience appraising companies in his capacity as the person in charge of the Company’s acquisition program. \textit{Swope}, 74 F. Supp. 2d at 884. Anderson estimated the fair market value of the Company based on “book value of the shares, earnings per year, the dividend history, and the rate projected to pay those dividends.” \textit{Id.} at 884, 886. Anderson also applied a minority discount of forty-five percent. \textit{Id.} at 886; see \textit{supra} note 5.
\item \textsuperscript{17} \textit{Swope}, 243 F.3d at 490. Of the twenty-three non-family shareholders, fifteen voted against the merger, five abstained or were not present at the meeting, and three voted in favor of the merger. \textit{Id.} The three non-family shareholders who voted in favor of the merger were Anderson and two other Company employees, who owned small blocks of Company stock. \textit{Id.; Swope}, 74 F. Supp. 2d at 885. Although Anderson was a shareholder, his principal interest was in his position as Chief Executive Operating Officer, for which his compensation, including salary and bonus, was about $1.4 million annually from 1995 to 1997. See \textit{Swope}, 74 F. Supp. 2d at 884.
\item \textsuperscript{18} \textit{Swope}, 243 F.3d at 490.
\item \textit{Id.}
\item \textsuperscript{19} \textit{Id.}
\item \textsuperscript{20} \textit{Id.} The minority shareholders could not elect to remain shareholders by refusing to sell their shares. Their only two options were to sell their interests in the Company at twenty dollars per share or to bring an appraisal action. See \textit{supra} note 10. Section 351.455 provides for the valuation of the interests of minority shareholders of a corporation who object to a proposed merger. See \textit{Mo. Rev. Stat. §} 351.455 (2000). The statute requires minority shareholders to: (1) file with the corporation a written objection to the proposed merger prior to or at the shareholders meeting at which the plan is to be submitted to the shareholders for a vote, (2) not vote in favor of the merger, and (3) make a written demand on the surviving or new corporation for payment of the fair value of the shares within twenty days of the merger. \textit{Id.} § 351.455.1. If the dissenting shareholders and the corporation are unable to agree on a fair price for the shares, the shareholders can file suit “asking for a finding and determination of the fair value of such
At the ensuing bench trial, expert witnesses valued the stock from as little as $30.00 per share\(^2\) to as much as $98.40 per share.\(^2\) The witnesses used three different methods of valuing the company: (1) "enterprise interest," which values a company based on what it could be sold for as a going concern, (2) "marketable minority interest," which assumes a market for the shares but discounts for the lack of control of minority shares, and (3) "non-marketable minority interest," which discounts the shares for both lack of control and lack of a market for the shares.\(^3\) The district court held that a minority discount was appropriate but a lack of marketability discount was not.\(^4\) The court valued the dissenters' shares at $63.36 per share.\(^5\) The court also awarded prejudgment interest.\(^6\) The Company appealed the judgment, and the minority shareholders cross-appealed to contest the application of a minority discount and the prejudgment interest rate the district court applied.\(^7\)

shares," and the judgment shall be "for the amount of such fair value as of the day prior to the date on which such vote was taken approving such merger or consolidation, together with interest thereon to the date of such judgment." \(\text{Id.} \) \$ 351.455.3. The district court found that it had diversity jurisdiction under 28 U.S.C. \$ 1332. \(\text{Swope}, 243 \text{ F.3d at } 490.\)

21. The Company's own expert valued the dissenting shareholders' stock at a range from $30.00 to $46.20 per share—at least fifty percent higher than the twenty dollar offer the Company made to the minority shareholders. \(\text{See Swope}, 74 \text{ F. Supp. 2d at 885.}\)

22. \(\text{Id. at } 885, 887.\)

23. \(\text{Swope}, 243 \text{ F.3d at } 490. \) The Company also submitted evidence that the estate of one of the dissenting shareholders valued Company shares at $18.50 for estate and inheritance tax purposes. \(\text{Id.}\)

24. \(\text{Id.}; \text{ see also supra note } 5\) and accompanying text.

25. \(\text{Swope}, 243 \text{ F.3d at } 490.\)

26. \(\text{Id.} \) The court awarded 5.115% simple interest based on the fifty-two-week T-Bill pursuant to 28 U.S.C. \$ 1961, which sets forth the interest rate for money judgments in civil cases decided in federal court. \(\text{Id.}\)

27. \(\text{Id. at } 490. \) The dissenting shareholders contended that an interest rate of nine percent should have been applied pursuant to Missouri Revised Statues Section 408.020. \(\text{Id. at } 497. \) The court agreed with the dissenting shareholders. \(\text{Id.} \) In addition to appealing the judgment, the Company also filed a Rule 60(b) motion, asking the court to consider an Internal Revenue Service report that valued the Company's majority stock at $45.69 per share for estate tax purposes. \(\text{Id. at } 490; \text{ see also Fed. R. Civ. P. } 60(b).\)

The district court denied the motion, but agreed to consolidate the appeals of both the judgment and the Rule 60(b) disposition. \(\text{Swope}, 243 \text{ F.3d at } 490-91.\)
After setting forth the facts of the case in its opinion, the trial court detailed the expert witnesses' valuations of the Company. The court noted that, although many methods of valuation can be utilized, they generally fall into three approaches: (1) the asset-based approach, which values each of the business units individually, adds them together, and subtracts corporate liabilities, resulting in shareholder equity; (2) the market approach, which compares the corporation with similar corporations; and (3) the income approach, which "attempts to value a business' entity at a given time based on present value of future economic income estimated to be realized by owners of the company." The court then detailed and evaluated the appraisal of Robert Reilly, the plaintiff's expert. Reilly calculated the enterprise value, that is, the value of the Company as a going concern without applying discounts, to be $98.40 per share, the marketable minority interest value to be $72.90 per share, and the non-marketable minority interest value to be $72.90 per share. Reilly testified that Missouri statutes and relevant literature required valuing the Company at its enterprise value, and, according to Reilly, applying the other levels of valuation in this case would result in the unjust enrichment of the majority shareholders. Reilly also testified that, in arriving at his appraisal value, he only considered data that were generated before the date of the merger. He observed that the Company's book value of $33.82 per share was a floor value that is a useful measure for liquidation purposes but not for appraising a going business.

29. Id. at 887-910.
30. Id. at 887.
31. Id. at 887-900. Reilly was formerly national director of valuation services as a partner with Deloitte & Touche before joining Williamette Company, where he structured and facilitated transactions. Id. at 887-88. Reilly was a certified public accountant and a member of the American Society of Appraisers. Id. at 888.
32. Id. at 887; see also supra text accompanying notes 22-23.
33. Swope, 74 F. Supp. 2d at 888.
34. Id. at 889. Missouri Revised Statutes Section 351.455 provides that the judgment shall be "for the amount of such fair value as of the day prior to the date on which such vote was taken approving such merger or consolidation." MO. REV. STAT. § 351.455.3 (2000). This has the effect of preventing dissenting shareholders from benefitting from corporate actions taken subsequent to the merger. In the instant case, the value of the minority shares was not increased by the expected tax savings from the anticipated Subchapter S election. See supra note 11.
35. Book value, an accounting concept, is "[t]he value at which an asset is carried on a balance sheet." BLACK'S LAW DICTIONARY 177 (7th ed. 1999).
36. Swope, 74 F. Supp. 2d at 890.
Reilly utilized three approaches in his appraisal.37 (1) the income approach method,38 (2) the direct capitalization method,39 and (3) the guideline publicly traded company method,40 first valuing each of the six units separately and then aggregating the values.41

The court then considered the testimony of the Company's experts.42 One of those experts, Z. Christopher Mercer, provided testimony that poked holes in the testimony of Reilly.43 Mercer criticized Reilly's "definition of fair value, application of his guideline company method, application of his direct capitalization method, application of his discounted cash flow method, and application of a control premium."44 The Company also offered the testimony of Kenneth Wayne Patton.45 Patton testified that both a minority and marketability discount should be applied to the valuation because there was no

37. Id.
38. "The income approach attempts to value a business entity at a given time based on present value of future economic income estimated to be realized by owners of the company." Id. at 887.
39. The direct capitalization method involves "capitalization of a period estimate of economic income by a direct capitalization rate." Id.
40. The guideline publicly traded company method compares publicly-traded companies to the company being valued. Id.
41. Reilly valued each of the divisions of the Company separately and then aggregated the values. Id. at 890. The court criticized Reilly's appraisal for selecting a growth rate for the Advantek unit of seven percent, which the court held was too high. Id. at 894. The court also faulted Reilly's selection of a beta of 0.38 for the Correl, Inc. unit, which the court thought was substantially too low. Id. at 895. (Beta is a measure of a company's risk as an investment; higher betas reflect higher risk and lower betas reflect lower risk.) Id. at 906. The court, thus, concluded that Reilly's valuation of Correl, Inc. was inflated. Id. at 895. The court criticized Reilly's valuation of the Continental Disc Corporation for its low beta and for his rounding in his calculations. Id. at 896. The court criticized Reilly's growth rate in his appraisal of the Dolch Computer Systems, Inc. unit as being too high, and the beta Reilly selected for the Sensidyne, Inc. unit as being too low. Id. at 896-97. The trial court also had the same criticisms of Reilly's valuation of the Company's Automotive & Appliance Division. Id. at 898. The court also criticized Reilly's rounding in his valuation of the Consolidated unit as well as the subjectivity of the method he used. Id. at 898-99.
42. Id. at 900-10.
43. Id. at 900. Mercer owned Mercer Capital Management, Inc., which provides valuation services. Id. He was formerly a member of the Board of Examiners of the American Society of Appraisers. Id.
44. Id.
45. Id. at 903. Patton is president of Mercer Capital, which is wholly owned by Mercer and Patton. Id. He was formerly vice chair of the Board of Examiners of the American Society of Appraisers, and he performs several hundred appraisals annually. Id.
market for the minority shares and because the minority shareholders lacked any degree of control of the Company.46

The trial court then turned to Missouri law to determine whether minority and marketability discounts should be used and concluded that such a determination is in the discretion of the trial court.47 The court then surveyed the law of other jurisdictions,48 and, based on this, concluded that a minority discount should be applied to the valuation, but a marketability discount should not.49

On the parties’ appeal and cross-appeal, the United States Court of Appeals for the Eighth Circuit considered, as a matter of law to be considered de novo, whether minority and lack of marketability discounts should be applied to the value of a dissenter’s shares under Missouri law.50 The court held that when minority shareholders bring suit under Missouri Revised Statutes Section 351.455, minority and marketability discounts should not be applied because such discounts would frustrate the purpose of the valuation statute, which is to protect the interests of minority shareholders.51 Thus, the appellate court reversed the district court’s application of a minority discount but affirmed the district court’s refusal to apply a marketability discount and remanded the case for a determination of “fair value” without the application of either discount.52

III. LEGAL BACKGROUND

Missouri Revised Statutes Section 351.455 provides minority shareholders of a corporation protection from the decisions of majority shareholders by providing for payment of the “fair value of [their] shares”53 in the event that the

46. Id.
47. Id. at 916.
48. Id. at 916-22.
49. Id. at 922.
51. Id. at 494-95.
52. Id. at 499.
53. Mo. REV. STAT. § 351.455.1 (2000). Section 351.455 reads in full:
1. If a shareholder of a corporation which is a party to a merger or consolidation shall file with such corporation, prior to or at the meeting of shareholders at which the plan of merger or consolidation is submitted to a vote, a written objection to such plan of merger or consolidation, and shall not vote in favor thereof, and such shareholder, within twenty days after the merger or consolidation is effected, shall make written demand on the surviving or new corporation for payment of the fair value of his shares as of the day prior to the date on which the vote was taken approving the merger
minority shareholders are "squeezed out" by a corporate merger or consolidation. The statute was the result of a legislative bargain that allowed majority shareholders to make fundamental changes in a corporation with less than unanimous shareholder consent as was required under the common law.

or consolidation, the surviving or new corporation shall pay to such shareholder, upon surrender of his certificate or certificates representing said shares, the fair value thereof. Such demand shall state the number and class of the shares owned by such dissenting shareholder. Any shareholder failing to make demand within the twenty day period shall be conclusively presumed to have consented to the merger or consolidation and shall be bound by the terms thereof.

2. If within thirty days after the date on which such merger or consolidation was effected the value of such shares is agreed upon between the dissenting shareholder and the surviving or new corporation, payment therefor shall be made within ninety days after the date on which such merger or consolidation was effected, upon the surrender of his certificate or certificates representing said shares. Upon payment of the agreed value the dissenting shareholder shall cease to have any interest in such shares or in the corporation.

3. If within such period of thirty days the shareholder and the surviving or new corporation do not so agree, then the dissenting shareholder may, within sixty days after the expiration of the thirty day period, file a petition in any court of competent jurisdiction within the county in which the registered office of the surviving or new corporation is situated, asking for a finding and determination of the fair value of such shares, and shall be entitled to judgment against the surviving or new corporation for the amount of such fair value as of the day prior to the date on which such vote was taken approving such merger or consolidation, together with interest thereon to the date of such judgment. The judgment shall be payable only upon and simultaneously with the surrender to the surviving or new corporation of the certificate or certificates representing said shares. Upon the payment of the judgment, the dissenting shareholder shall cease to have any interest in such shares, or in the surviving or new corporation. Such shares may be held and disposed of by the surviving or new corporation as it may see fit. Unless the dissenting shareholder shall file such petition within the time herein limited, such shareholder and all persons claiming under him shall be conclusively presumed to have approved and ratified the merger or consolidation, and shall be bound by the terms thereof.

4. The right of a dissenting shareholder to be paid the fair value of his shares as herein provided shall cease if and when the corporation shall abandon the merger or consolidation.

54. Id. § 351.455.

In order to be entitled to receive "fair value" for their shares, the statute requires dissenting shareholders to file with the corporation a written objection to the proposed consolidation or merger prior to the shareholders meeting in which a vote is to be taken on the consolidation or merger.\footnote{56} In addition, a dissenting shareholder must not vote in favor of the merger and must make a written demand within twenty days after the merger or consolidation on the surviving or new corporation "for payment of the fair value of his shares as of the day prior to the date on which the vote was taken approving the merger or consolidation."\footnote{57} Failure to provide such demand to the corporation will give rise to a presumption that the shareholder consented to the corporate action.\footnote{58}

If the dissenting shareholder can come to an agreement with the corporation concerning the value of the shares within thirty days after the merger or consolidation, the corporation is required to pay that amount within ninety days after the corporate action, and the dissenting shareholder must surrender his or her certificates.\footnote{59} This surrender extinguishes the shareholder's interest in the corporation.\footnote{60}

If the dissenting shareholders and the corporation fail to come to an agreement concerning the value of the dissenting shareholder's shares within thirty days, the dissenter has sixty days to file an appraisal action requesting a court to determine the "fair value" of the shares and to order payment of that amount.\footnote{61} Upon payment of the judgment, the shareholder's interest in the corporation is extinguished.\footnote{62} Failure to petition a court for relief within the allotted time gives rise to a presumption that the shareholder consented to the shareholders for the sale of all [or] substantially all of the corporate assets.") (quoting Flarsheim v. Twenty Five Thirty Two Broadway Corp., 432 S.W.2d 245, 252 (Mo. 1968)). Although Flarsheim dealt specifically with Section 351.405, which provides protection in the event of a sale of all or substantially all of a corporation's assets, the Swope court applied the same reasoning to Section 351.455. See Swope, 74 F. Supp. 2d at 912. The common law required unanimous shareholder consent "as a prerequisite to fundamental corporate change."\footnote{63} However, Missouri Revised Statutes, Chapter 33, Article 6, Section 5361 (1939), the precursor to Missouri Revised Statutes Section 351.455, required a three-fifths majority of shareholders to approve a merger, while Section 351.455 requires a two-thirds majority.\footnote{64} 

\footnote{56} MO. REV. STAT. § 351.455.1 (2000).
\footnote{57} Id. "Such demand shall state the number and class of the shares owned by such dissenting shareholder."\footnote{65} Id.
\footnote{58} Id.
\footnote{59} Id. § 351.455.2.
\footnote{60} Id.
\footnote{61} Id. § 351.455.3.
\footnote{62} Id.

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corporate action. If the corporation abandons its plans to merge or consolidate, the dissenter no longer has a right to be paid fair value for his or her shares.

Although many jurisdictions have similar appraisal statutes, the definition of "fair value" varies from jurisdiction to jurisdiction, and the law in Missouri on the issue is unsettled. While the Missouri statute requires corporations to pay squeezed-out shareholders the fair value of their shares, the statute does not state how fair value is to be calculated. The Missouri Supreme Court discussed the meaning of "fair value" in Phelps v. Watson-Stillman Co.:

In the various statutes the terms "value," "fair value," "fair cash value," and "fair market value" are abstract and in a sense perhaps meaningless. [T]hey nevertheless have the same general meaning and purposefully if not wisely establish a flexible general standard for fixing value between parties who are either unable or unwilling to voluntarily agree. As previously noted, there is no simple mathematical formula and each case presents its particular problem, but in general some of the factors to be considered and weighted are asset value, earnings, dividends, management, and "every relevant fact and circumstance which enters into the value of the corporate property and which reflects itself in the worth of corporate stock."

Whether to apply minority and marketability discounts is an essential issue to resolve in appraisal actions. Missouri case law interpreting Missouri Revised Statutes Section 351.455 is sparse. In Phelps v. Watson-Stillman Co., the Missouri Supreme Court rejected the valuation of a referee who had been appointed by the trial court to determine the fair value of dissenters' shares. In Phelps, the referee established the net asset value, that is, liquidation value, of the corporation. The Phelps court rejected using that method as the sole means

63. Id.
64. Id. § 351.455.4.
68. See Swope, 243 F.3d at 490.
69. 293 S.W.2d 429, 432 (Mo. 1956).
70. Id. at 432.
71. See id. at 431-432.
of determining fair value of dissenters’ shares. The Phelps court, however, did not address whether to apply minority or marketability discounts.

The most recent Missouri appraisal rights case addressing whether to apply minority or marketability discounts is King v. F.T.J., Inc. The King court held that the application of minority and marketability discounts rests within the "sound discretion of the trier of fact after every relevant fact and circumstance is considered." King gives only limited guidance as to when such discounts should be applied because it merely found that the trial court had not erred in declining to apply a marketability discount to the dissenters’ stock. Still, the King court did reason that application of a minority discount may be appropriate when:

The judgment of the trial court reflects the fact that in the case at bar, Karen King’s status as a minority shareholder diminished the value of her stock to the extent that the stock represented her interest in the active operation of the insurance agency and her lack of a controlling voice in that aspect of the company’s business, but not to the extent that her stock represented an interest in the saleable assets held by the company that were not necessary in the operation of the insurance agency business.

This reflects the reason most often cited by courts for applying a minority discount, that is, “that minority shareholders’ lack of control over significant corporate decisions diminishes the value of their stock, and that the fair value of their stock must reflect this reality.”

Dreiseszun v. FLM Industries, Inc., a Section 351.405 appraisal case, gives support to applying Section 351.405 cases’ definition of “fair value” to Section 351.455 cases. The Dreiseszun court rejected application of a minority discount, reasoning:

72. Id. at 432.
73. See Swope, 74 F. Supp. 2d at 912.
74. 765 S.W.2d 301 (Mo. Ct. App. 1988).
75. Id. at 306.
76. See Swope, 74 F. Supp. 2d at 913.
77. King, 765 S.W.2d at 306.
78. Swope, 74 F. Supp. 2d at 914.
79. 577 S.W.2d 902 (Mo. Ct. App. 1979).
80. Section 351.405 is the appraisal statute for the sale of all or substantially all of a corporation’s assets. See Mo. Rev. Stat. § 351.405 (2000).
81. Dreiseszun, 577 S.W.2d at 905-06.
It would appear, therefore, that the court below in the situation before it would place a different "fair value" per share upon the same classification and kind of stock in a corporation depending upon whether the shares were held by a majority or a minority stockholder, and would find the value of the minority shares to be the amount which the majority stockholders were willing to pay for the minority shares and which a minority shareholder was willing to accept, whether a "fair value" or not, and hold the other minority shareholders to the consequences of that decision. Such is not the legal import or effect of § 351.405. . . . This statute does not by terms or any reasonable interpretation intend that a minority shareholder be in any way penalized for resorting to the remedy afforded thereunder. . . . The minority dissenting shareholders . . . enjoyed certain fundamental rights as common stockholders in [the company], which are thus generally expressed in 18 C.J.S. Corporation § 215, p. 648: "A common stockholder is an owner of the enterprise in proportion that his stock bears to the entire stock and ordinarily he is entitled to participate in the management, profits and ultimate distribution of assets of the corporation." Or, as stated differently, a share of common stock is evidence of unit ownership of the whole, each unit being of equal value such that their sum equals the value of whole. 18 C.J.S. Corporations § 515, p. 1194.82

Dreiseszun thus requires valuation of a company as a going concern without applying minority or marketability discounts when arriving at a "fair value" under Section 351.405.83

The most recent judicial application of Missouri Revised Statutes Section 351.455 prior to Swope was Hunter v. Mitek Industries, Inc.84 The Hunter court followed Dreiseszun's conclusion that both minority and marketability discounts should be rejected: "Under Missouri law, the dissenting shareholder is entitled to his proportionate interest or pro rata share in the overall fair value of the corporation, appraised as a going concern."85 Thus, Hunter used the enterprise value to valuate the dissenting shareholders' shares.86 Hunter also cited Flarsheim regarding the purpose of Section 351.455: "The purpose of the

82. Id. at 906, 908 (quoted in Swope, 74 F. Supp. 2d at 914).
83. See Swope, 74 F. Supp. 2d at 915. Although King quoted Dreiseszun, it rejected Dreiseszun's rejection of a minority discount, and held that application of such a discount was in the discretion of the trier of fact. See King, 765 S.W.2d at 306.
84. 721 F. Supp. 1102 (E.D. Mo. 1989).
85. Id. at 1106.
86. Id.
appraisal statute is to award the dissenter the value of what he owned, his proportionate interest in the going concern, in exchange for giving up his control power over significant changes.”

Hunter further reasoned that Section 351.455 “was designed primarily for the protection of the dissenting shareholders and the award of fair value being the substitute for the control power or value the minority relinquished.”

Other state courts have also interpreted appraisal statutes that are similar to Section 351.455, the most significant being Delaware and Illinois. In *Rapid-American Corp. v. Harris*, the Delaware high court held that dissenting shareholders’ shares should be valued according to the corporation’s enterprise value without imposing either a minority or a marketability discount. In contrast, an Illinois appellate court affirmed a trial court’s imposition of minority and marketability discounts in *Weigel Broadcasting Co. v. Smith*. Delaware precedent is important because of “Delaware’s experience in questions of corporate law,” while Illinois precedent is important because Missouri’s appraisal statute was patterned after the Illinois statute. In other states, “a number of courts have held that application of discounts is discretionary and was proper in the circumstances of the case.” At the same time, some courts have applied a marketability discount while rejecting a minority discount, while other courts have rejected both discounts.

**IV. INSTANT DECISION**

The United States Court of Appeals for the Eighth Circuit first held that application of both marketability and minority discounts was not warranted in the instant case. The court began its analysis by stating:

> [W]hile the ultimate determination of fair value is a question of fact, the determination of whether a given fact or circumstance is relevant to fair value under Mo.Rev.Stat. § 351.455 is a question of law which

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87. Id. at 1106-07.
88. Id. at 1107.
89. 603 A.2d 796 (Del. 1992).
90. Id. at 805.
93. Id.
94. Id. at 918 (citing cases from Illinois, Mississippi, Georgia, Indiana, and Kansas).
95. Id. (citing cases from New York, Oregon, and Kentucky).
96. Id. (citing cases from Nebraska and Maryland).
we review de novo. In the present case, the Company contends that the lack of control over minority shares and the absence of a liquid market are relevant circumstances which reduce the value of the stock, warranting not only a minority discount, but also a lack of marketability discount. On de novo review of these issues of law, we disagree.97

Next, the court noted the rule of Dreiseszun v. FLM Indus., Inc., that “every relevant fact and circumstance” should be considered in valuing a company.98 The court reasoned that, rather than imposing a “simple mathematical standard,” the Missouri Supreme Court has established “a flexible general standard” for fixing the value of a company,99 and the determination of fair value “rests within the sound discretion of the trier of fact after every relevant fact and circumstance is considered.”100 Whether a given fact or circumstance is relevant, however, is a matter of law that the appeals court reviews de novo.101

The court then looked to the purpose of the appraisal statute for guidance in deciding whether minority and marketability discounts are relevant facts and circumstances.102 The appraisal statute was enacted to balance the General Assembly’s decision to allow major corporate transactions to be effected with majority rather than unanimous shareholder consent.103 According to the court, in order to protect minority shareholders “from being deprived of their ownership interests,” the appraisal statute provided an “equitable remedy” to compensate minority shareholders and “ensur[e] that they retain the same proportionate value of their stock regardless of undesired changes dictated by majority vote.”104 Based on this, the court found that “the proper valuation of minority stock must calculate the value of the corporation as a whole and award a pro-rata share of that value to the dissenting shareholders.”105 This value, the court concluded, should be equal to the value of majority shares.106 The court cited the approach of the American Law Institute, which does not impose a minority discount and which also shuns a marketability discount “absent

98. Id. (quoting Dreiseszun v. FLM Indus., Inc., 577 S.W.2d 902, 907 (Mo. Ct. App. 1979)).
99. Id. (quoting Phelps v. Watson-Stillman Co., 293 S.W.2d 429, 433 (Mo. 1956)).
100. Id. (quoting King v. F.T.J., Inc., 765 S.W.2d 301, 306 (Mo. Ct. App. 1988)).
101. Id.
102. See id.
103. Id.
104. Id. at 491-92.
105. Id. at 492.
106. Id.
extraordinary circumstances." The court then distinguished "fair value" from "fair market value": "Contrary to the Company's contention, 'fair value' in minority stock appraisal cases is not equivalent to 'fair market value.'" The court then contrasted the appraisal statute's purpose of giving dissenting shareholders the value of their shares before the merger with the purpose of marketability discounts and found them incompatible: "The purpose of a marketability discount is to 'adjust for a lack of liquidity in one's interest in an entity, on the theory that there is a limited supply of potential buyers for stock in a closely-held corporation.'" Because dissenting shareholders in an appraisal action are not willing sellers, the court concluded that a marketability discount is inappropriate. In support of this finding, the court stated that "[t]he marketability discount is incompatible with the purpose of the appraisal right, which provides dissenting shareholders with a forum for recapturing their complete investment in the corporation after they are unwillingly subjected to substantial corporate changes beyond their control." The court further reasoned that "[i]mposing a marketability discount would benefit the majority shareholders at the expense of the minority shareholders, in direct conflict with the purpose of the statute." The court held:

We conclude that the market for minority stock in a dissenting shareholders' appraisal proceeding, absent extraordinary circumstances, is not a relevant fact or circumstance to consider when determining fair value. We hold that the facts of the present case do not constitute extraordinary circumstances warranting a discount for lack of marketability in the determination of the fair value of the stock. Rather, the illiquid nature of the stock is precisely the type of minority stock held in a close corporation which Missouri's appraisal statute is designed to protect. To remain consistent with this purpose of compensating the dissenting shareholders for the full proportionate value of their stock, we affirm the decision of the district court to refrain from discounting the minority stock for lack of marketability. . . . Because the district court's determination of the stock price falls

107. Id. (quoting AMERICAN LAW INSTITUTE, STANDARDS FOR DETERMINING FAIR VALUE, PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 7.22(a) (1994)).
108. Id.
109. Id. at 493 (quoting Lawson Mardon Wheaton, Inc. v. Smith, 734 A.2d 738, 747 (N.J. 1999)).
110. Id.
111. Id.
112. Id.
within the range proposed by the experts discussed in its opinion, we hold that there has been no error.\textsuperscript{113}

Turning to the question of minority discounts, the court again contrasted the purpose of the appraisal statute with the purpose of the discount and found these two purposes to conflict as well.\textsuperscript{114} According to the court, the purpose of a minority discount is to account for lack of control, but because the dissenting shareholders are not willing sellers, to impose a discount for the fact that they would have trouble selling their shares would result in giving them less in compensation than what they are being forced to give up.\textsuperscript{115} The court stated that "[w]e . . . hold that minority status of the stock is not a relevant fact or circumstance to be considered in a dissenting shareholders’ appraisal proceeding. Therefore, a minority discount is incompatible with the accurate determination of fair value under § 351.455."\textsuperscript{116}

V. COMMENT

Although the reasoning of the United States Court of Appeals for the Eighth Circuit is compelling with regard to imposing marketability discounts, it falls short with regard to minority discounts. The purpose of Missouri Revised Statutes Section 351.455 is to compensate minority shareholders for the property they are forced to sell against their will. Under the common law, minority shareholders were protected by their ability to veto any major corporate action, and the appraisal statute was designed to protect minority shareholders when the common law rule was abandoned in favor of majority rule in corporate actions. Allowing for majority rule provides corporations with the flexibility to make decisions without being bogged down by minority shareholders who could delay the process by holding out for unreasonable terms and, at the same time, the appraisal statute ensures that minority shareholders who are squeezed out will be compensated fairly for their ownership interest.

In Swope, the court reasoned that the majority shareholders would receive a windfall if they could force minority shareholders to sell their shares when there was not a market for them, as in the case of a close corporation. In effect, the majority shareholders would be the only market, and they would have the power to set the price they would pay. By applying a marketability discount in an appraisal action, the court would only assist the majority shareholders in being unfair to minority shareholders. Besides being unfair to the plaintiffs in

\begin{itemize}
\item \textsuperscript{113} Id. at 494.
\item \textsuperscript{114} Id. at 495.
\item \textsuperscript{115} See id.
\item \textsuperscript{116} Id. at 496.
\end{itemize}
the instant case, such court action would encourage majority shareholders to
squeeze out minority shareholders in the hope of receiving such a windfall.

There is some question, however, as to whether Section 351.455 was the
result of a legislative bargain as both the trial court and the appeals court assume.
Both the trial court and the appeals court remarked that the statute was a
legislative bargain that replaced the protection of requiring unanimous
shareholder consent with the protection of ensuring that minority shareholders
who were squeezed out in the event of a merger were fairly compensated. But
it is not completely clear that such a bargain was struck in Missouri. The
plaintiffs rely on Flarsheim v. Twenty Five Thirty Two Broadway Corp. 117 for the
proposition that such a bargain took place in relation to Missouri Revised
Statutes Section 351.405, which deals with appraisal when a corporation sells or
exchanges all or substantially all of its assets and property. 118 The plaintiffs
argued that the same reasoning should apply to appraisals under Section
351.455. 119 The defendants countered with the argument that such a bargain
never took place because the “Missouri legislature has never predicated a
statutory merger on the shareholders’ unanimous consent.” 120 The 1939 statute
that preceded Section 351.455 required a three-fifths vote of the shareholders to
approve a merger. 121 Thus, Section 351.455, which requires a two-thirds
shareholder vote, actually increases the percentage of shareholders that would
be required to approve a merger. 122 Although the trial court agreed with this
point, it rejected the defendant’s argument. The court reasoned that the common
law required unanimous consent for “fundamental corporate change,” 123 and “the
Missouri legislature did diminish minority shareholders’ power when it first
removed this common law requirement of unanimity,” 124 apparently because
appraisal statutes protected minority shareholders by ensuring that they would
receive fair value. 125

It is also possible that in refusing to apply a minority discount the Eighth
Circuit could actually be giving minority shareholders a windfall. When shares
of a corporation are traded publicly, they trade at a discount to account for the
lack of control, but when a person purchases a large block of stock that would
give him or her control of a company, the shares are often sold at a price that is

117. 432 S.W.2d 245 (Mo. 1968).
119. Id. at 912.
120. Id.
121. Id.
122. Id.
123. Id.
124. Id.
125. See id.
higher than the current market price to reflect a control premium. When the Eighth Circuit required the trial court to give the plaintiffs a pro rata share of the value of the corporation as a going concern, the court in effect gave the plaintiffs a pro rata share of the control premium also, but, as minority shareholders, the plaintiffs did not have control of the Company, so they did not lose control in the squeeze-out. Thus, giving the minority shareholders a pro rata share of the corporation may have given them a windfall.

Another troubling aspect of the court’s decision is the fact that the Eighth Circuit disregarded a Missouri court of appeals decision that made the imposition of marketability and minority discounts a matter of the trial court’s discretion. After evaluating the appropriate Missouri case law, the trial court in *Swape* concluded that, in Missouri, trial courts have discretion concerning whether to apply such discounts, but the Eighth Circuit concluded as a matter of law that neither discount should be applied. The court acknowledged that its decision cut against Missouri precedent but, nonetheless, concluded that if the Missouri Supreme Court decided a Section 351.455 case, it would overturn the precedent of the lower Missouri courts. The issue seems to be whether the Missouri Supreme Court would follow Delaware law, which is quite influential in corporate law matters, or Illinois law, which was the basis for Missouri’s appraisal statute. It seems that the question could go either way, and given that both a Missouri appeals court and a United States district court had previously concluded that Missouri would follow Illinois cases, the *Swape* trial court and the Eighth Circuit should also have followed Illinois precedent.

VI. CONCLUSION

Although the Missouri Supreme Court has not decided a Section 351.455 case that directly addresses the issue, the United States Court of Appeals for the Eighth Circuit predicted that the Missouri high court would reject both minority and marketability discounts. Although the *Swape* court’s reasoning with regard to marketability discounts is persuasive, the case for rejecting minority discounts is less persuasive. The purpose of the appraisal statute is to compensate dissenting shareholders for what has been taken from them against their will—their ownership interest in a corporation. Because the context is that of a forced sale to the majority shareholders, it would be inequitable to discount minority shares for the lack of a market. To do so would encourage squeeze-outs and provide a windfall to corporations who constitute the only market for the shares.

The purpose of minority discounts, on the other hand, is to account for the lack of control inherent in minority shares. Because control over corporate decisions is valuable, and because shares which would give the buyers control over a corporation often trade at a premium, giving dissenting shareholders a pro rata share of the company without accounting for the lack of control would give
dissenters a windfall. Thus, the Swope court was probably wrong to reject minority discounts as a matter of law.

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