

BUSINESS VALUATIONS UNDER CORPORATIONS CODE §2000

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I. INTRODUCTION

Corporations Code §2000 is a remedial statute invoked by a corporation to stay the proceedings of a dissolution. Under §2000, the corporation or the purchasing parties may avoid the dissolution of the corporation by purchasing the plaintiffs' shares for cash. When properly invoked, the court shall stay the winding-up and dissolution proceeding and shall proceed to ascertain and fix the fair value of the shares owned by the moving parties.

This paper is limited to the business valuation aspects of Corporations Code §2000; it does not deal with the procedural strategies of this area of practice. Section 2000 business valuations are quite unique and the attorney should be aware of the nuances of the legal and valuation issues before undertaking these types of cases.

Many CPAs and appraisers do not understand the statutes and case laws that control the area of corporate dissolution or the business valuation theory and methodology that applies. This outline, along with the instructor's presentation, is designed to provide an overview of the applicable law and valuation principles. It is not intended to be an authoritative treatise on the subject.

II. STATUTORY FRAMEWORK

A) **Overview.** At the outset, it is important to note that Corporations Code §2000 is invoked by a defendant corporation (or shareholder) to avoid a threatened dissolution of the corporation that has been filed under Corporations Codes §1800 or §1900. By properly invoking §2000, the dissolution proceedings will be suspended, the fair value of the moving parties' shares will be determined, and the defendant(s) will be given the opportunity to purchase the shares for cash.

The legal procedures surrounding these causes of action are complex and the ambiguity of the statutes gives rise to many factual disputes. Surprisingly, there are relatively few cases interpreting the statutes. With respect to pure business valuation issues, there are only three significant cases: *Brown v. Allied Corrugated Box Company, Inc.* (1979); *Abrams v. Abrams-Rubaloff & Associates, Inc.* (1981), and *Ronald v. 4-C's Electronic Packaging, Inc.* These cases are discussed in Section IV of this outline.

B) **§1800 - Involuntary Dissolution.** Section 1800 sets forth the statutory framework for involuntary dissolution of a corporation by shareholders. In general, the plaintiff shareholders must have both the grounds to sue for involuntary dissolution and the authority to sue for involuntary dissolution. Subsection (a) grants the power to bring this action to the following persons:

1) One-half or more of the directors in office.

- 2) Shareholders who hold shares representing not less than 33% of the total equity of the corporation, exclusive of shares owned by persons who have participated in the alleged wrongful activity.
- 3) Any shareholder, if the period for which the corporation was formed has terminated.
- 4) Any other person expressly authorized to do so in the articles.

Subsection (b) sets forth the grounds for involuntary dissolution as follows:

- 1) Unfairness in Small Corporations. In corporations with 35 or fewer shareholders, liquidation is reasonably necessary for the protection of the rights or interests of the minority shareholder(s).
 - 2) Improper Conduct by Those in Control.
 - a) The controlling shareholders have committed
 - i) Pervasive fraud, mismanagement and abuse of authority, or
 - ii) Persistent unfairness toward any shareholder, or
 - b) Those in control are misapplying or wasting corporate property.
 - 3) Board Deadlock. If there is an even number of directors that are so divided regarding the management of the corporation that
 - a) Business cannot be conducted, or
 - b) The business will be impaired or lostand:
 - c) The shareholders are so deadlocked that they cannot elect an uneven number of directors.
 - 4) Shareholder deadlock. The shareholders are so deadlocked that:
 - a) The business can no longer be advantageously conducted, or
 - b) The shareholders have failed at two consecutive annual meetings to elect successor directors.
 - 5) The corporation has abandoned its business for more than one year.
- C) §1900 - Voluntary Dissolution.**

Section 1900 sets forth the procedure by which a corporation may elect to voluntarily dissolve. In summary, a corporation may elect to dissolve by the votes of shareholders holding shares representing 50% or more of the voting power.

D) §2000 - Avoidance of dissolution by purchase of plaintiff's share, valuation, vote required, stay of dissolution proceedings, appraisal under court order, confirmation by court appeal. Section 2000(a) provides that the corporation or certain shareholders may avoid the dissolution of the corporation and the appointment of any receiver by purchasing for cash the shares owned by the moving parties at their fair value. *"The fair value shall be determined on the basis of the liquidation value as of the valuation date but taking into account the possibility, if any, of sale of the entire business as a going concern in a liquidation."* (Emphasis added). Additionally, the moving parties may be charged with damages resulting from the action if the initiation of the dissolution is a breach of an agreement with the purchasing parties, with certain exceptions.

THE APPRAISAL PROCESS

1) Who may purchase the shares?

a) The corporation may purchase the plaintiffs' shares with the approval of the holders of a majority of each class of shares entitled to vote, excluding shares held by the plaintiffs. (Note: The corporation is bound by certain solvency tests set forth in §§500 through 503 of the Corporation's Code.)

b) Shareholders owning at least fifty percent of the outstanding shares may purchase the plaintiffs' shares if the corporation fails to do so.

2) Determining "fair value." If the parties cannot agree to a purchase price, the statute sets forth a process for establishing the fair value of the shares.

a) The statutory procedure (§2000(b)(3)) requires the purchasing party to post a bond as security to pay the estimated reasonable expenses (including attorney's fees) of the moving parties in an appraisal process.

b) When a bond has been posted, the Court shall appoint three disinterested appraisers to appraise the fair value of the shares owned by the moving parties. The Court is empowered to make an order prescribing the time and manner of producing evidence, if evidence is required, and any other procedures to be followed by the appraisers. (Frequently, the Court will look to the parties for suggestions in this area.)

c) Assumptions.

i) Valuation date. The statute states that the valuation is to be performed as of the date upon which the Court proceedings were commenced unless one party can persuade the Court to designate some other date.

ii) Standard of valuation. The standard set forth in the statute is "fair value." This standard is discussed at length, *supra*.

iii) Other. The parties may jointly dictate other assumptions to the appraisers, such as continuity of management, existence of important contracts, continuity of particular employees, continuing existing relations with affiliates, etc. Obviously, different assumptions can significantly affect the valuation conclusions.

d) Decision of the appraisers. The statute provides that the award of the appraisers or of a majority of them, when confirmed by the Court, shall be final and conclusive upon all parties. (The statute is silent on what happens if the three appraisers cannot agree.)

e) Deductions from the valuation. If the plaintiffs breached a provision in the Articles, By-Laws or other agreement by moving for dissolution, the amount of any damages resulting to the purchasing parties may be deducted from the purchase price of the shares unless the ground for dissolution is improper conduct by those in control.

f) Time to purchase shares. When the Court confirms the appraiser's decision, it will set a time within which the defendants must purchase the plaintiff's shares. If the defendants do not pay for the shares within that time, the Court will automatically enter an order for dissolution and the Court must order the amount of the defendants' bond paid over to the plaintiffs, subject to proof of the plaintiffs' expenses.

III. VALUATION CONSIDERATIONS

A) **Standard of Value.** A standard of value is the definition of the type of value being sought in a particular assignment. Typical examples of standards of value are:

1) Fair market value - The amount at which property would change hands between a willing seller and a willing buyer when neither is acting under compulsion and when both have reasonable knowledge of the relevant facts. (American Society of Appraisers Business Valuation Standard I, 1992).

2) Investment value - Value to a particular investor based on individual investment requirements, as distinguished from the concept of market value, which is impersonal and detached. Investment value is the specific value of goods or services to a particular investor for individual investment reasons. (See Pratt, *Valuing Small Businesses and Professional Practices*, Second Edition).

3) Liquidation value - The net amount that can be realized if the business is terminated and the assets are sold piecemeal. (Pratt, *id*).

B) Unique standard of value in §2000.

1) Fair value - "The fair value shall be determined on the basis of the liquidation value as of the valuation date but taking into account the possibility, if any, of sale of the entire business as a going concern in a liquidation."

2) The statutory standard of value appears to be a blend of two antithetical standards, liquidation value and fair market value. Liquidation is not based on the premise of the business as going concern. Fair market value, on the other hand, is based on a hypothetical transfer of the business as an operating, going concern.

3) By adding the consideration of the possibility of the sale of the entire business as a going concern in a liquidation, the statutory language appears to strive for some blend of a liquidation value and a full going concern value.

4) Given the language of the statute, it would appear that if a business is considered to be salable in the marketplace, the appropriate measure of its value for §2000 would be a "quick sale" fair market value. This measure would appear to most closely approximate the "sale of the entire business as a going concern in a liquidation."

5) Given the statutory language, if a business is not considered to be salable as a going concern (i.e., some type of non-transferable personal service business), it would appear that the appropriate measure of its value for §2000 should be liquidation value.

IV. RELEVANT CASE LAW

A) There are a number of California cases that interpret different aspects of Corporations Code §2000, but there appear to be only **three** cases that significantly comment on the standard of value or the appropriate valuation methods to be considered. The cases interpreting the non-valuation aspects of §2000 are not dealt with in this outline.

The full text of this article is available by contacting our office.

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