Shareholder Dissension, Even Over Coffee

By Randy G. Gullickson

Shareholders owning a minority block of stock in a corporation generally lack the ability to prevent transactions involving fundamental changes to the corporation or the nature of their investment in it. However, when fundamental corporate change is forced upon minority shareholders against their will, Minnesota law allows shareholders to "dissent" from the transaction and to exercise statutory "dissenter's rights" designed to protect them from what they view to be adverse effects of such change. Assuming that dissenting shareholders jump through the proper procedural hoops to perfect their dissenter's rights, the primary remedy to which they are entitled comes in the form of a "fair value" buyout of their shares. Rather than be trapped as an unwilling shareholder in a company that has gone through change that they found to be unacceptable, the dissenting shareholders are entitled to have their shares purchased according to a valuation formula deemed by law to be fair.

Transactions that implicate dissenter's rights of shareholders include:

- Merger transactions.
- Stock exchanges with an acquiring entity.
- Conversion of the corporation into a limited liability company.
- Amendments to articles of incorporation that materially and adversely affect rights or preferences of shares.
- Certain sales or dispositions of substantially all of a corporation's assets.

Because of Minnesota's dissenter's rights statute, a shareholder is not required to go along with such transactions, but instead can "dissent" and thereby be entitled to tender his or her shares in return for a payment of "fair value." The dissenting shareholder and the company have the opportunity to agree on what constitutes fair value. If they cannot agree, a court in a trial before a judge (not a jury), will determine fair value. This setting is often viewed as favoring the dissenting minority shareholder, though a recent court case involving one of your favorite local coffee shops did not turn out quite that way.

The built-in protection for minority shareholders stems in part from the method of calculating "fair value," which is a valuation standard favorable to minority shareholders because unlike "fair market value," a determination of fair value generally will not include application of valuation discounts based on the minority status or lack of marketability of the shares. In addition, if it becomes necessary to resolve the issue of fair value in court, a corporation that has failed to comply substantially with the dissenter's rights statute (which according to some Minnesota court cases can include a pre-litigation tender to dissenting shareholders of an amount determined to be less than fair value), may have to pay the legal fees and expenses of the dissenting shareholder.

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In some dissenter's rights scenarios, the underlying transaction does not establish a cash price for the stock. For example, transactions involving an elimination of share redemption rights, an exchange of stock, or a conversion to a limited liability company, do not involve a stock purchase as a part of the transaction itself and therefore, no purchase price is set. When a shareholder dissents from a transaction of this kind, there is no actual market price to point to and the determination of what constitutes a fair value purchase price of a dissenter's shares is usually determined by a battle of business appraisal experts.

In other types of dissenter's rights transactions, such as cash-out mergers, the transaction itself includes a specific cash

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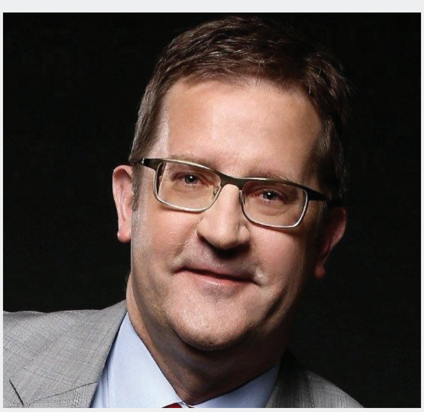

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price offered for a shareholder's stock. Assuming this purchase price was determined in an arms-length negotiated transaction, the cash-out price is likely to be viewed by many to constitute fair value. In a 2004 case involving the Rainforest Cafe, for example, the purchase price tendered by an acquirer to the corporation's shareholders was $3.25 per share. After a trial in which the dissenting shareholder presented expert testimony advocating a fair value of $6.10 per share while the company's experts contended that fair value was $3.00 per share, the court – perhaps not surprisingly – ruled that fair value was $3.25 per share, the same price received by the shareholders who did not dissent. In doing so, the court concluded that the merger price was determined in an arms-length fashion was a strong (though not the sole) indicator that the merger price was equal to fair value.

Although never stated in Minnesota case law, some lawyers and business owners undoubtedly assumed that as a practical matter the actual cash-out merger price in a transaction of this kind would likely set the floor in a determination of the fair value of shares. If this assumption were accurate, it would give dissenting shareholders upside opportunity to potentially recover more than shareholders who did not dissent, while avoiding the potential to receive a lower buyout price. A recent Hennepin County district court decision involving Minnesota-based Caribou Coffee Company upended such an assumption.

In 2013, Caribou Coffee Company – at the time was publicly traded – was acquired in a merger transaction by a private company that before this transaction (and after) acquired other coffee companies. Some Caribou Coffee Company shareholders exercised their dissenter's rights, in response to which the Caribou Coffee Company tendered to the dissenters $15.03 per share, the amount the company contended actually constituted fair value. After a week-long trial, a Hennepin County district court judge ruled that fair value of the dissenter's shares was actually only $14.45, well under the $16.00 merger price (in a merger transaction that the court described as arms-length) and that the dissenters had been paid in full by their receipt of $15.03 per share. The court explained that synergies and other values resulting from a merger are not relevant factors in determining fair value of the dissenter's shares and therefore, shareholders who dissent from a merger transaction of this kind run the risk of recovering less than the merger price they would have received had they not dissented. In Delaware, the home state for a large number of going-private transactions generating dissenter's rights litigation, the dissenter's rights statute expressly requires that the fair value paid to dissenters is "exclusive of any element of value arising from the accomplishment or expectation of the merger." Based on the Caribou Coffee Company decision, it appears that Minnesota courts will adopt a similar approach despite the absence of this language in the Minnesota dissenter's rights statute.

Minnesota's dissenter's rights law provides minority shareholders with important protections from major corporate changes with which they disagree. However, the Caribou Coffee Company decision teaches that there are potential risks, as well as rewards that can go along with the exercise of those dissenter's rights.