

Fair Price for Minority Shareholders



By Joel Weinstein

An employee holding a minority interest in the company often encounters the challenge of securing fair value for the shares if his/her employment is terminated. This article discusses key points that counsel should address when representing a minority shareholder and the benefits of retaining an experienced business valuation expert ("BVE").

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Buying Out a Minority Shareholder

Recently, a minority shareholder was terminated and the employer demanded that he sell back his shares. The shareholder held a 25% stock interest in one company ("Demo Co.") and a 33% interest in a related leasing company ("Lease Co."). Demo Co. had a shareholders agreement with a buy-sell provision that only triggered on the death of a shareholder. The repurchase price was to be the shares' book value plus 25%. The agreement did not provide for an appraisal method for determining fair market value, and was silent on a buyout in the event of a termination of employment. Previously, the company had used book value without a premium as the basis for repurchasing another minority shareholder's shares upon employment termination. For Lease Co., the shareholders had an agreement containing buyout rights upon death, withdrawal, resignation or retirement with the repurchase price set at book value plus 15%.

The minority shareholder asked us to advise him on his rights and their demand to buy back his shares. The result, described below, generated for the minority shareholder almost 25% more than the company's book value for his Demo Co. shares and nearly 50% above the company's initial repurchase offer for all of his shares.

Legal Counsel and Business Valuation Expert as Teammates

The first step was to retain an experienced business valuation expert. By working as a team, counsel and the business valuation expert can most effectively determine whether the agreed upon method for valuing the shares as presented in the shareholders agreement or, in our situation where there was no agreed

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Is Your Website Inside Information?



By Benjamin M. Alexander

Companies increasingly rely on their websites as a primary means of communications with the world - including investors. As broadband becomes more widespread and the Internet becomes a primary marketplace, this trend will continue. The Securities and Exchange

Commission, however, has never included a company's website among the recognized ways of ensuring that any information disclosed by the company is publicly disclosed.

Under federal securities laws, a public company is obligated to make any material information publicly available before it makes any other disclosure of that information. Simply stated, information is material if there is a substantial likelihood that a reasonable investor would consider the information important in making a decision with respect to a security.

Disclosing nonpublic, material information to some people, but not everyone - selective disclosure - is prohibited by the Securities Exchange Act and Regulation FD. Regulation FD identifies only two means of disclosure that are safe harbors - methods that a company can use for disclosure and be assured that the information was disclosed publicly - a press release or Form 8-K filed with the SEC. The safe harbors don't prohibit alternative means of disclosure, but a company can't know in advance whether the SEC will consider it adequate. This leads to the counterintuitive result that when a public company posts material information on its website, that posting needs to be preceded (or at least made simultaneously with) a press release or a Form 8-K containing the same information. Posting information on a company's website only potentially is selective disclosure.

The SEC's New Guidance

The SEC issued an interpretive release on August 1, 2008 addressing website disclosure. Although the release doesn't formally change any rules, it does allow companies to increase their reliance on their websites to communicate with investors. The release

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upon valuation method, reflects fair market value. Typically, negotiations will occur over whether discounts for lack of marketability and minority interests should be applied in reducing the fair market value.

Then, we needed to determine whether a trigger event had actually occurred under the buy-sell agreement. Close attention always needs to be given in the shareholders agreement to potential trigger events such as death, disability, employee termination, or resignation; otherwise a withdrawing shareholder may retain his or her shares. When the employee contests the grounds for the termination, counsel may need to take more assertive action to seek remedies for the employee. In situations when the employee and the company desire a mutual termination of their relationship, again the grounds for the termination are important in effecting a fair buy-out price.

Another question is the company's source of funding for the purchase price, and its ability to satisfy the purchase price based on the proposed payment terms. Upon termination, other than upon death or disability, insurance is not available for funding the buyout; therefore, the company's operations, assets and the ability to liquidate those assets need to be closely scrutinized.

The due diligence for valuation purposes is paramount to maximize the purchase price to be paid. The BVE needs to employ practical experience and deep operational and financial knowledge to review the company's financial statements and interview senior management. The BVE often can find items on the company's books that are incongruent with highly conservative projections made by senior management that impact future payments to the outgoing shareholder. In our situation, the BVE was able to glean from senior management off balance sheet assets and income that routinely occurred for projects. Closer scrutiny of the company's business practices and off balance sheet value by the BVE enabled us to maximize the return for our client.

Buy-Sell Agreements

Buy-sell agreements are particularly important for closely held businesses because there is no ready market for selling an ownership interest. Without a buy-sell agreement, the party that wants to sell is at a bargaining disadvantage, as is the group that desires to buy out a nonperforming shareholder. The purpose of a buy-sell agreement is to restrict the shareholder's ability to transfer his/her ownership interest. Since disputes and disagreements inevitably arise among shareholders, an owner should be able to exit without forcing the remaining owners into an uncomfortable business relationship with new owners, possibly competitors.

Drafted properly, a buy-sell agreement keeps the corporate shares in the hands of those active in the business and fixes the value of those shares upon trigger events. If the buy-sell agreement is combined with a mandatory purchase option agreement, it can provide a ready market for closely held ownership interests when shareholders die or withdraw from the business. The buy-sell agreement also can establish a value for the equity and can provide for contingencies such as disability, divorce, insolvency or incapacity.

The buy-sell agreement should specify the method for determining the purchase price. Common methods include a fixed price per share, an appraisal by an independent BVE to establish the fair market value, or a formula such as an earnings multiplier or a percentage of book value. Buy-sell agreements are intended to avoid litigation by which the owners prepare for unusual but foreseeable events that have an impact on the businesses. They can become detrimental if the shareholders do not fix an appropriate price or update the agreed price or do not fix an appropriate valuation method.

Even with careful drafting for the repurchase of the shares, the buy-sell agreement may not be enforceable if the company does not satisfy the retained earnings test or balance sheet test under California law. A back-up mandatory purchase or purchase option held by the other shareholders to purchase the shares, can provide another source of funds.

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also addresses other issues arising from website disclosures, but this article addresses only whether a company that posts information on its website needs to make it public at the same time through other means.

The SEC concludes that "we now believe that technology has evolved and the use of the Internet has grown such that, for some companies in certain circumstances, posting of the information on the company's website, in and of itself, may be a sufficient method of public disclosure under . . . Regulation FD."

Each company remains responsible for determining whether its website meets the requirement of Regulation FD that postings be "reasonably designed to provide broad, non-exclusionary distribution of the information to the public." However, the release provides some guidance to determine when that requirement is met:

1. Is the website a recognized distribution channel?
2. Does posting on the website disseminate the information in a manner making it available to the securities marketplace in general?

The release also provides a list of non-exclusive factors

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to consider in answering those two questions. Among the factors identified are:

- Whether companies let investors know that the company has a website and that they should look at the company's website for information;
- Whether the company has made investors and the markets aware that it will post important information on its website;
- Whether it has a pattern of posting important information on its website;
- Whether the company's website is designed to lead investors efficiently to information about the company;
- Whether information posted on the website is picked up by readily available media and the size of the company involved;
- Steps the company has taken to make its website and the information accessible, including the use of "push" technology such as RSS feeds, or releases through other channels either to widely distribute such information or advise the market of its availability;
- Whether the company keeps its website current and accurate; and
- Whether the company uses other methods in addition to its website posting to disseminate the information and whether and to what extent those other methods are the predominant methods the company uses to disseminate information.

Practical Application

Although the guidance does not provide the absolute security of a defined safe harbor, the factors set out by the release provide a roadmap to use a company's website as a primary medium for communicating with

the investing public. Standards of practice will develop and evolve. Initially, a public company wishing to rely on its website can take several practical steps, including:

1. In every Form 10-K, Form 10-Q, proxy statement, annual report to stockholders and press release, include the website address and state "Please visit our website at [address]. We routinely post important information about our company and your investment in it on our website and that information may not be available elsewhere."
2. Post all important information about the company and investments in it on the website.
3. Announce through a press release and a Form 8-K that the company will be relying on the website for communications to the investing public. Identify the information to be posted. If possible, provide a schedule and stick to it.
4. Define an easily found central location for investor information on the website. There should be a prominent link from the home page, with the date of the last change to the investor information. The investor information page should also prominently display the date of the last update.
5. Consider, until a routine is established, press releases announcing updates, which don't include the information. For example, a press release announcing that a new letter to stockholders is available on the website.

This list is not exhaustive and needs to be tailored to the situation of each company. The SEC's guidance is highly dependent on the facts and circumstances of each company. If you are a public company considering changing your disclosure practices in light of this release, please contact a member of our Corporate and Securities Group.

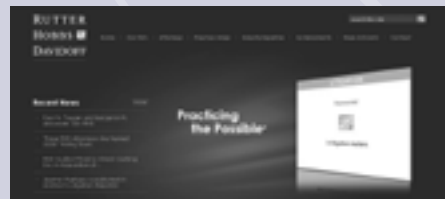
RHD ATTORNEY UPDATE



We are pleased to welcome Benjamin M. Alexander to the firm's Corporate and Securities practice group. Benjamin's primary focus is on corporate finance, mergers and acquisitions, securities compliance and corporate governance. He also provides counsel to a wide range of technology companies on general corporate matters and licensing, joint ventures and strategic alliances. Benjamin earned his J.D. from the University of Pennsylvania in 1992. He can be reached at (310) 286-1700 or balexander@rutterhobbs.com.

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- Represented Stone Harris & Stone in the sale of its assets to Brown and Brown Insurance.

Securities & Financings

- Represented underwriters in the \$15 million IPO of a biomedical company.

- Advised an investor in making a control investment in a publicly-traded entertainment company.
- Represented Advance Biotherapy, Inc. (OTC BB: ADVB.OB) in its convertible note investment in, and credit facility guaranty for, Organic Farm Marketing.
- Led an electric car manufacturer in its \$5 million PIPE (private investment in public equity) offering of common stock.
- Represented a publicly-held company during the SEC's 18-month long review of its annual and quarterly reports and financial statements.
- Represented alternative energy company in its proxy contest with dissident stockholder group.
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