

STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS

KENT, SC.

SUPERIOR COURT

[Filed: December 11, 2015]

DAVID L. QUINN, individually :
and derivatively on behalf of :
SILVERMINE BAY, INC., :
Plaintiff :

v. :

C.A. No. KC-2015-0272

LOUIS YIP, TZE PING NG and :
ERIC LEUNG, :
Defendants. :

DECISION

STERN, J. The matter before the Court is a shareholder dispute alleging minority shareholder oppression. David L. Quinn (Plaintiff), a shareholder of Silvermine Bay, Inc. (Silvermine), brought this action directly and derivatively against Louis Yip (Yip), Tze Ping Ng (Ng), and Eric Leung (Leung), (collectively, Defendants), the remaining shareholders of Silvermine. Defendants filed an “Election to Purchase Shares Owned by David L. Quinn” (Motion for an Election), alleging that because Plaintiff’s complaint invokes liquidation statutes, Defendants have an unqualified right to purchase Plaintiff’s shares. Plaintiff counters that the motion is premature as liquidation has yet to be elected as a remedy. Jurisdiction is pursuant to G.L. 1954 §§ 7-1.2-1314 and 7-1.2-1323. For the following reasons, the Court grants Defendants’ Motion for an Election.

I

Facts¹ and Travel

Plaintiff is a twenty percent shareholder of Silvermine, a company incorporated in 1996. The remaining shares are divided unequally among Defendants. Less than two weeks after the Articles were filed, they were amended, reducing Silvermine's Board of Directors (the Board) to five members and effectively removing Plaintiff from his position on the Board.

Silvermine made distributions to its shareholders between 1997 and 2000. In 2000, Silvermine ceased making distributions to Plaintiff but continued to make distributions to other shareholders. Plaintiff submitted several inquiries to Yip, who was acting President of the Board, regarding the status of Plaintiff's investment. As a result of Yip's insufficient response to Plaintiff's inquiry, Plaintiff sent a letter to Yip demanding to inspect the books and records of Silvermine. Two months after Plaintiff's request, Yip authorized the accountant of Silvermine to meet with an accountant hired by Plaintiff and review the financials. During this inspection, it became clear to Plaintiff's accountant that Yip had not furnished all the requested materials. As a result, on December 29, 2011, Plaintiff sent a letter to Yip, noting his lack of compliance with the document request, and made additional, specific requests for certain records. Yip acknowledged receipt of the demand, but failed to produce the requested documents.

Plaintiff, at his own expense, had a "cash flow analysis" prepared. According to this analysis, \$940,000 in total cash flow was potentially available to the shareholders between 1996 and 2010. Of that amount, roughly \$425,000 was loaned to various other shareholders, and \$100,000 was loaned to Yip's other business organizations. None of the loans charged interest to its debtor. Moreover, starting in 1999, Yip began to pay himself between \$10,000 and

¹ The following facts are garnered from the parties' papers. The Court makes no finding as to the validity of these facts, but recites them to provide context for the motions before the Court.

\$15,000 annually for “management fees.” As of 2010, he has paid himself a total of \$149,200 in “management fees.” Further, Yip paid Kwai Chun Leung (Chun Leung), a relative of Yip, \$6000 annually for “management fees.” As of 2010, Yip has paid Chun Leung a total of \$59,000 in “management fees.”

Plaintiff filed a complaint on March 30, 2015, which (1) seeks an appointment of a special master pursuant to § 7-1.2-1314; (2) demands an inspection of the books and records of Silvermine pursuant to § 7-1.2-1502; (3) requests an accounting of Silvermine’s business operations pursuant to §§ 7-1.2-1314 and 7-1.2-1502; (4) alleges breach of the fiduciary duty owed to Silvermine; and (5) alleges breaches of the fiduciary duties of care and loyalty owed to Plaintiff, personally. Plaintiff also sought an appointment of a Special Master, and one was appointed to conduct a forensic audit of the business operations of Silvermine. Subsequently, on October 8, 2015, Defendants filed a Motion for an Election. The motion was scheduled for hearing on November 12, 2015, but prior to the hearing, the parties indicated to the Court that they wished to waive oral argument on the Motion for an Election and rested on their papers.

II

Analysis

Defendants, as majority shareholders, seek to purchase Plaintiff’s shares at fair value. Defendants aver that their election to purchase is proper because they have an absolute right to purchase Plaintiff’s shares under § 7-1.2-1315, which grants such right when a Plaintiff petitions for dissolution of a corporation. Conversely, Plaintiff contends that, because dissolution is not imminent, and is only a possible—not exclusive—remedy, Defendants’ election to purchase Plaintiff’s shares is premature. Further, Plaintiff maintains that Defendants’ suggestion that they have an unqualified right to elect to purchase Plaintiff’s shares is meritless.

A

Timing of the Election to Purchase

The Rhode Island Business Corporation Act (RIBCA)² provides several remedies to shareholders of a company facing dissolution, one being an election to purchase a minority shareholder's shares. See § 7-1.2-1315. Section 7-1.2-1315, entitled "Avoidance of dissolution by share buyout," (the Election Statute) states, in pertinent part, the following:

"Whenever a petition for dissolution of a corporation is filed by one or more shareholders (subsequently in this section referred to as the 'petitioner') pursuant to either § 7-1.2-1314 or a right to compel dissolution which is authorized under § 7-1.2-1701 or is otherwise valid, one or more of its other shareholders may avoid the dissolution by filing with the court prior to the commencement of the hearing, or, in the discretion of the court, at any time prior to a sale or other disposition of the assets of the corporation, an election to purchase the shares owned by the petitioner at a price equal to their fair value." (Emphasis added.)

The Election Statute explicitly allows for an election to purchase a shareholder's shares in three instances: (1) when a petition is brought pursuant to § 7-1.2-1314; (2) when a right to dissolution exists under § 7-1.2-1701; or (3) if the right to dissolution is "otherwise valid."

1

Dissolution Under § 7-1.2-1314

If a plaintiff petitions the Court for dissolution under § 7-1.2-1314, such petition will serve as an impetus for Defendants to act pursuant to the Election Statute and exercise their right of election to purchase the Plaintiff's shares. See § 7-1.2-1315. Section 7-1.2-1314, in pertinent part, states the following:

"(a) The superior court has full power to liquidate the assets and business of a corporation:

² The RIBCA is codified at G.L. 1956 §§ 7-1.2-101, et seq.

“(1) In an action by a shareholder when it is established that, whether or not the corporate business has been or could be operated at a profit, dissolution would be beneficial to the shareholders because:

“(ii) The acts of the directors or those in control of the corporation are illegal, oppressive, or fraudulent; or

“(iv) The corporate assets are being misapplied or are in danger of being wasted or lost; or

“(v) Two (2) or more factions of shareholders are divided and there is such internal dissension that serious harm to the business and affairs of the corporation is threatened” (Emphasis added.)

Though Defendants argue that § 7-1.2-1314 is a liquidation statute because it provides the Superior Court with such power, the Supreme Court has found that prior to liquidation under § 7-1.2-1314, a Plaintiff must first establish that dissolution would be beneficial to the corporation. See Levine v. Bess Eaton Donut Flour Co., 705 A.2d 980, 983 (R.I. 1998). In Levine, the Court explained that the statute is “explicit on its face in requiring that a shareholder seeking the liquidation of a corporation must establish that ‘dissolution would be beneficial’^[3] to him or her; the statute does not require that a petition for dissolution be filed before a shareholder may petition the court to appoint a receiver.” Id. The Court upheld a trial court’s determination that the plaintiff “did not establish that liquidation would not be appropriate” because “plaintiff expressly claimed that liquidation of defendant’s assets and business was not being sought, and asserted his fiduciary duty as trustee to preserve the value of the trusts’ assets in defendant corporation.” Id. at n.1. In doing so, the Court noted that, under § 7-1.2-1314, a petition for a

³ It should be noted that liquidation and dissolution are two distinction actions. See Peck v. Jonathan Michael Builders, Inc., 940 A.2d 640, 644 (R.I. 2008) (“Although . . . liquidation and dissolution are distinct concepts . . . they inextricably are linked. Under § 7-1.2-1320, an insolvent corporation is required to seek court supervision to dissolve after liquidation of its assets is complete.”). Accordingly, pursuant to § 7-1.2-1314, a plaintiff must prove that the subsequent remedy of dissolution is proper as a prerequisite to liquidation of the company’s assets.

receiver will not necessarily be followed by a liquidation of a company. Id. at 983. For instance, a non-liquidating receiver could be “appropriate” and would serve as a

“lifeline to shareholders and other affected parties when no other relief appears to be adequate, when it is likely to benefit most if not all interested parties by allowing the corporation to continue to operate, or when it will help to protect the interests of the shareholders by preserving company assets from being dissipated if they are in imminent danger of further loss or waste.” Id.; see also 16 William Meade Fletcher et. al., Cyclopedia of the Law of Private Corporations § 7667.50 (1998) (“The appointment of a receiver does not of itself dissolve a corporation, nor, indeed, does it necessarily lead to the dissolution of the corporation or the winding up of its business.”).

Here, under § 7-1.2-1314, Defendants’ motion is premature as Plaintiff has yet to allege that dissolution would be beneficial. Plaintiff’s complaint seeks the following:

“[T]he appointment of a special master to secure and preserve the assets of Silvermine Bay and, if necessary and upon further petition and order of the Court, a permanent receiver to liquidate the assets and business of Silvermine Bay and enter a decree dissolving Silvermine Bay. In addition, Plaintiff seeks (1) access to and review of the corporate books and records pursuant to R.I. Gen. Laws § 7-1.2-1502; (2) a full and complete accounting of the business affairs of Silvermine Bay; (3) restitution from the Controlling Defendants, and in particular Yip, of any and all diverted corporate funds and opportunities; (4) damages deriving from the wrongful conduct of Yip; and (5) an award of the costs of bringing this litigation including attorneys’ fees and costs.” Pl.’s Compl. at ¶ 5 (emphasis added).

At this point in the proceedings, while Plaintiff’s complaint expressly invokes § 7-1.2-1314, it does not satisfy the condition precedent requiring allegations or proof that dissolution is beneficial. See Levine, 705 A.2d at 983. Further, as in Levine, Plaintiff has expressly stated that liquidation is not being sought. Plaintiff alleges that liquidation is not yet necessary and only seeks the appointment of a special master to “secure and preserve the assets of Silvermine Bay.” Pl.’s Compl. at ¶ 5. It expressly states that liquidation may only be necessary “upon

further petition and order of the Court.” Id.; see Levine, 705 A.2d at 983 (liquidation not appropriate because “plaintiff expressly claimed that liquidation of defendant’s assets and business was not being sought”). Additionally, the mere fact that Plaintiff’s complaint petitions for a Special Master under § 7-1.2-1314 will not afford Defendants a right to elect to purchase Plaintiff’s shares, as the Special Master could be utilized for non-liquidating purposes. See Levine, 705 A.2d at 983 (a receiver can serve as a “lifeline” to a shareholder to preserve the assets of the business). As Plaintiff has not stated or alleged that dissolution would be beneficial, Defendants’ right to elect to purchase Plaintiff’s shares cannot arise from the inclusion of § 7-1.2-1314 in Plaintiff’s complaint.

2

Dissolution Under § 7-1.2-1701

A petition under § 7-1.2-1701 will also give rise to Defendants’ rights under the Election Statute. See § 7-1.2-1315. However, as Plaintiff’s complaint neither mentions nor asserts rights under § 7-1.2-1701, it cannot serve to trigger Defendants’ rights under the Election Statute.

3

Dissolution by an “Otherwise Valid” Petition

An “otherwise valid” petition for dissolution is the final way that Defendants’ right for an election to purchase may be realized. See § 7-1.2-1315. The Supreme Court has yet to define what constitutes an “otherwise valid” petition for dissolution; however, it has held that “oppressive behavior” can be grounds for shareholder buyout. See Hendrick v. Hendrick, 755 A.2d 784, 790 (R.I. 2000).

In Hendrick, the Court noted that the plain language of § 7-1.2-90.1—the predecessor to the current Election Statute—permits “a corporation, rather than be forced to dissolve by a

shareholder dissolution petition, [to] elect to buy out the shareholder's stock.” Id. at 790. The Court held that in determining if a buyout is appropriate, a trial court should look to the essence of the Plaintiff's pleadings. Id. at 792. The Court explained that a trial court should not “focus[] exclusively on each count”⁴ of Plaintiff's pleadings, but should rather make a “broader inquiry into an alleged pattern or series of acts” of the Defendant. Id. In so holding, the Court found error in a trial court's failure to give substantive consideration to the Plaintiff's pleadings under the Election Statute. Id.

In giving substantive consideration to the pleadings, the Hendrick Court suggested that if a Plaintiff's pleading alleges oppression, the remaining shareholders may elect to purchase the Plaintiff's shares. Id. at 790-92. Simply, rights under the Election Statute will arise upon a prerequisite finding of minority shareholder oppression in the pleadings.⁵ Id. The Hendrick Court, at length, discussed what constituted “oppressive behavior,” citing three situations relating to (1) “reasonable expectations” of the shareholders; (2) the “heightened good faith” obligation of the shareholders; and, (3) a “freeze out” of a shareholder.

The “reasonable expectations” view “define[s] oppressive conduct as conduct that substantially defeats the ‘reasonable expectations’ held by minority shareholders in committing their capital to the closed corporation.” Id. at 791. “This approach takes into account the fact that shareholders in close corporations may have expectations that differ substantially from those of shareholders in public corporations.” Id. The “heightened good faith” standard defines

⁴ Defendants engaged in a “count-by-count” analysis of Plaintiff's complaint, contravening our Supreme Court's instruction in Hendrick. See 755 A.2d at 790.

⁵ Further, the Court held that in instances where oppression is not evidenced, a buyout may—pursuant to the Election Statute—still be warranted “when there appear[s] no prospect for harmony between the shareholders and long-term injunctive control of the actions of the majority shareholders [is] not practicable.” Id. (citing A. Teixeira & Co. v. Teixeira, 674 A.2d 407, 408 (R.I. 1996)).

oppressive behavior as “conduct which deviates from a heightened good faith standard that exists in closely held corporations, a more stringent standard than found in their public counterparts.”

Id. Lastly, the “freeze out” situation defines oppressive behavior as the conduct of majority shareholders when they “refuse to declare dividends; they may drain off the corporation’s earnings in the form of exorbitant salaries and bonuses to the majority shareholder-officers and perhaps their relatives . . . [and] they may deprive minority shareholders of corporate offices and of employment by the company.” Id. at 791-92. The Court further noted that “Oppression also has been found to exist where the majority shareholders have engaged in waste of the corporate assets . . . or where relevant financial information is withheld from shareholders.” Id. at 792.

After analyzing these definitions, the Court concluded that:

“oppression within a closely held corporation can manifest itself as a series of acts or a pattern of conduct by majority shareholders that can have the cumulative, overall effect of freezing out or depriving the minority shareholder of a voice in the corporation, as well as manifesting itself in more distinct, identifiable actions.” Id.

A recent Superior Court decision, Marsh Builders, Inc., v. Billington Farms LLC, 2007 WL 2344029, at *2 (R.I. Super. Ct. Aug. 10, 2007), cited Hendrick for the proposition that “[w]hen a shareholder seeks dissolution, the non-petitioning shareholders may avoid dissolution of the corporation . . . by purchasing the shares of the petitioning party under the buyout statute. This often occurs when a controlling owner is accused by a minority owner of oppressive conduct.” Id. (Emphasis added.) The Marsh Court explained that the Election Statute is preferred to take effect upon the allegations of oppressive conduct because “[i]nstead of engaging in costly litigation over whether dissolution is appropriate, the corporation’s existence continues under the ownership of the purchasing party, and the petitioner no longer participates in the company’s future successes and failures.” Id.; see also Chu v. Sino Chemists, Inc., 192

A.D.2d 315, 317 (N.Y. 1993) (“An election to purchase is superior to dissolution because it permits the continuation of the corporation’s existence.”). The court further explained the following:

“[t]he buyout statute usually serves to avoid significant expenditures of resources on litigation. Because the buyout election often occurs before a court has made a finding of oppression, the election statutes, in most instances, effectively create a no-fault ‘divorce’ procedure. The company at issue continues as a going concern under the control of the majority shareholder, the allegedly aggrieved investor is cashed out of the business, and no finding of wrongdoing is made by the court.” Id. at n.5.

New York has a similar shareholder buyout statute to that of Rhode Island. See N.Y. Bus. Corp. Law § 1118(a). New York’s statute, entitled “Purchase of petitioner’s shares; valuation” (NY Election Statute), provides that “[i]n any proceeding brought pursuant to section eleven hundred four-a of this chapter,” a shareholder may, within ninety days of the filing of the petition, “elect to purchase the shares owned by the petitioner at their fair value” Id. It explicitly states that the right to elect to purchase only exists only if the proceeding is brought “pursuant to section eleven hundred four-a [(NY Dissolution Statute)].” Id. A proceeding is initiated under the NY Dissolution Statute when a qualified shareholder in a closely held corporation makes a petition for dissolution under two circumstances: when those in control of the corporation have (1) engaged in fraudulent or oppressive conduct toward the complaining shareholders, or (2) wasted or looted the corporation’s assets. N.Y. Bus. Corp. Law § 1104-a. New York Courts have held that “a petition alleging grounds specified in [the NY Dissolution Statute] triggers the right of any other shareholder or shareholders or the corporation to elect to purchase the shares owned by the petitioners at their fair value.” Ferolito v. Vultaggio, 99 A.D.3d 19, 25 (N.Y. 2012). Therefore, when a petition alleges oppressive conduct or waste of

the corporation's assets, the remaining shareholders are entitled have a right to elect to purchase the oppressed shareholder's shares at fair value.

Additionally persuasive to the Court is § 14.34 of the Model Business Corporation Act (MBCA),⁶ entitled "Election to purchase in lieu of dissolution" (the MBCA Election Statute). The MBCA Election Statute provides that "[i]n a proceeding under section 14.30(2) to dissolve a [closely held] corporation . . . one or more shareholders may elect to purchase all shares owned by the petitioning shareholder at the fair value of the shares." Section 14.30(2)(ii) and (iv) of the MBCA, entitled "Grounds for judicial dissolution" (MCBA Dissolution Statute), states that a court may dissolve a corporation in a proceeding⁷ by a shareholder if it is established that (1) "the directors or those in control of the corporation have acted, are acting, or will act in a manner that is illegal, oppressive, or fraudulent"; or (2) "the corporate assets are being misapplied or wasted." Therefore, in any civil action that establishes oppressive behavior or corporate waste, the remaining shareholders have a right to purchase the oppressed shareholder's shares.

Several publications reaffirm the timing of an election to buy a minority shareholder's shares. One states that "[w]hen a shareholder petitions a corporation into receivership, Rhode Island law allows the non-petitioning shareholder to elect to purchase the shares owned by the petitioner at a price equal to their fair value." Brenner and Killian, A Practical Guide to Discovery and Depositions in Rhode Island § 30.5.1 (2014). Another, in a section entitled "Shareholder Disputes," warns lawyers to "[b]e aware of the election of shares remedy when considering commencement of a receivership petition by a shareholder in a shareholder dispute

⁶ The NY Election Statute is substantially similar to § 14.34 of the MBCA.

⁷ Section 1.40(18) of the MBCA defines "proceeding" as any "civil suit and criminal, administrative, and investigatory action."

and the possible impact on the petitioning shareholder.” Diane Finkle, et al., Attorney Practice Guide: Creditors’ and Debtors’ Rights, 56 R.I.B.J. 9, 10 (2008). This is because “R.I. Gen. Laws § 7-1.2-1315 enables the non-petitioning shareholder to avoid the receivership by buying the petitioner’s shares at ‘fair value.’” Id.

Here, due to Plaintiff’s allegations in his complaint, Defendants must have a right to elect to purchase Plaintiff’s shares. Pursuant to Hendrick, upon review of the substance of the complaint, it is apparent that Plaintiff’s cause of action centers on shareholder oppression, specifically a “freeze out.” See 755 A.2d at 790-92. Plaintiff alleges that he has been excluded from the board of directors and management of the company, that he has been denied access to the corporate books and records, and has been excluded from all knowledge and information pertaining to the business’s financial situation. These are the types of actions that Hendrick would classify as a “series of acts or a pattern of conduct by majority shareholders that can have the cumulative, overall effect of freezing out or depriving the minority shareholder of a voice in the corporation, as well as manifesting itself in more distinct, identifiable actions.” 755 A.2d at 792. Further, the majority shareholders have acted in such a way as to refuse Plaintiff dividends, use the corporation’s earnings to pay exorbitant salaries of Yip and Chun Leung, and to deprive Plaintiff of his position on the Board or of any employment by the company. See id. There can be no other classifications of Defendants’ actions except that of a “freeze out.” As such, under Hendrick, the remaining shareholders may elect to purchase the Plaintiff’s shares because Plaintiff alleges a “freeze out.”

Additionally, under Hendrick, Plaintiff’s complaint alleges oppression inasmuch as Defendants “have exercised control over Silvermine Bay in such a way as to misapply and waste corporate assets” and have withheld financial information from Plaintiff. See id. (Oppression

exists where the majority shareholders engage in waste of the corporate assets, or “where relevant financial information is withheld from shareholders.”). Specifically, Defendants did not supply Plaintiff with requested documents pertaining to the financial status of Silvermine, and have allegedly wasted corporate assets by compensating Yip and his relatives with “management fees.” As a result of such allegations of oppressive conduct, Defendants have a right to purchase Plaintiff’s shares.

Moreover, the NY Dissolution Statute and the MBCA lend credence to the proposition that Plaintiff’s complaint, while not specifically labeled a petition for dissolution, falls under the auspices of an “Otherwise Valid” petition for dissolution due to its specific allegations of minority shareholder oppression. See N.Y. Bus. Corp. Law § 1104-a. Further, both the NY Election Statute and MBCA Election Statute affirm that upon allegations of oppressive conduct or waste, the remaining shareholders have a right to elect to purchase the oppressed shareholder’s shares. See N.Y. Bus. Corp. Law § 1118(a); Ferolito, 99 A.D.3d at 25.

Lastly, as a policy consideration, failing to grant Defendants’ Motion for an Election would be to force a tumultuous relationship between Plaintiff and Defendants. To do so would condemn the company to an adversarial proceeding, litigating almost every action taken by any shareholder. It logically follows, pursuant to Hendrick, that allegations of such oppression by Plaintiff should enable Defendants to purchase Plaintiff’s shares. Such a ruling is beneficial to both Plaintiff and Defendants. As Silvermine is a close corporation, there is no active market for Plaintiff’s shares. Plaintiff will benefit by receiving the fair value of his shares while Defendants gain the unchallenged management of Silvermine, avoid litigation, and maintain the status quo. Thus, due to the specific minority shareholder oppression actions alleged, the applicability of

Hendrick, and the guidance of the MBCA and NY Election Statutes, the Court grants Defendants' Motion for an Election.

B

Fair Value of the Shares to be Purchased

As this Court has granted Defendants' motion, the Election Statute provides a specific procedure that must be followed in determining the fair value of the shares to be purchased. See § 7-1.2-1315. First, notice must be given "to all shareholders of the corporation other than the petitioner, giving them an opportunity to join in the election to purchase the shares." Id. Then, "[i]f the parties are unable to reach an agreement as to the fair value of the shares," this Court is required, upon giving of a bond or security by the purchasing shareholders, to stay the action "and determine the value of the shares, in accordance with the procedure set forth in § 7-1.2-1202." Id. However, to get to this point, it is requisite that the "parties are unable to reach an agreement." Id. Accordingly, this Court grants the parties two weeks' time, from the issuance of this Decision, to negotiate the fair value of Plaintiff's shares and report to the Court whether an agreement has been reached. If the fair value of the shares can be agreed upon, the Court will issue an order directing the purchase of the shares, identifying the value of the shares, and when payment for the shares is to be made. Id. However, if no such agreement can be reached, this Court will require a bond from Defendants. Upon Defendants posting the bond, the Court will stay the proceedings and determine the fair value of the shares by the procedure set forth in § 7-1.2-1202. Id.

In the event a bond is required, it must be in an amount "sufficient to assure to [Plaintiff] payment of the value of the shares." § 7-1.2-1315. Therefore, the bond must be in an amount equal or greater than the fair value of Plaintiff's shares. Such requirement essentially tasks the

Court to determine the fair value of the shares before a formal valuation is conducted so that it can guarantee that the bond is sufficient to assure Plaintiff payment of the value of his shares. In the instant matter, this poses a unique problem as the fair value of Plaintiff's shares may be artificially inflated or deflated by the alleged underlying breaches of fiduciary duty and care. For example, Plaintiff alleges corporate waste in the form of invalid loans and payments, which, in determining the fair value of his shares necessary for sufficient bond, could be viewed as corporate assets.

“Fair value” has seldom been defined; it is a question “which is addressed only generally in statutes, if at all.” F. Hodge O’Neal and Robert B. Thompson, Oppression of Minority Shareholders and LLC Members § 7:20 (2015). The RIBCA provides no definition of what constitutes “fair value,” leaving the term open for interpretation. Similarly, the MBCA provides no such definition in the purview of a shareholder election to purchase, but it does offer the following:

“If the parties are unable to reach agreement, any or all terms of the purchase may be set by the court under subsection (d). Section 14.34 does not specify the components of “fair value,” and the court may find it useful to consider valuation methods that would be relevant to a judicial appraisal of shares under section 13.30.” MBCA § 14.34, comment 4(b).

Section 13.30—contained in Subchapter C, entitled “Judicial Appraisal of Shares”—relies upon the definition of “fair value” found in § 13.01, which provides that the “fair value” of a shareholder’s shares is the:

- “value of the corporation’s shares determined:
- “(i) immediately before the effectuation of the corporate action to which the shareholder objects;
 - “(ii) using customary and current valuation concepts and techniques generally employed for similar businesses in the context of the transaction requiring appraisal; and

“(iii) without discounting for lack of marketability or minority status except, if appropriate, for amendments to the articles pursuant to section 13.02(a)(5).”^{8]}

The MBCA acknowledges that while an appraisal and election to purchase are not analogous, the Court should nonetheless “consider all relevant facts and circumstances of the particular case in determining fair value.”⁹ Id. More specifically, in situations where a majority shareholder elects to purchase shares from a minority shareholder who alleges oppression or corporate waste, “it would be appropriate to include as an element of fair value the petitioner’s proportional claim for any compensable corporate injury.”¹⁰ MBCA § 14.34, comment (4)(b).

Here, while the Court need not decide the amount of the bond to be posted—as the parties first have an opportunity to determine “fair value” themselves—it finds it prudent to advise the parties of how the Court will calculate the bond if the parties do not decide on a mutually agreeable “fair value” for Plaintiff’s shares. In light of the RIBCA’s silence on quantifiably determining “fair value,” this Court will look to the MBCA and utilize its definitions and guidance. In receiving a value from the previously appointed appraiser, the Court may supplement that value with the monetary total of alleged shams or questioned transactions, waste, and oppressive conduct. See id. Further, the shares will not be discounted on the basis that they lack majority voting power, or that there is no active market for selling such shares.

⁸ Rhode Island has accepted that a court should refuse to discount the minority shareholder’s shares due to the fact that the shares lack a controlling value or readily available market. See DiLuglio v. Providence Auto Body, Inc., 755 A.2d 757, 774 (R.I. 2000).

⁹ Similarly, New York and Delaware appraisals statutes explain that a court should utilize “all relevant factors” for valuation. See Del. Code Ann. tit. 8, § 262(h); NY Bus. Corp. Law § 623(h)(4).

¹⁰ Such instances should be considered by the court because “[a]nticipating the buyout of a minority shareholder, majority shareholders and the directors and officers they control may manipulate a corporation’s financial records to show no or little book value of assets and low or no earnings.” For instance, “they may create sham corporate debts and cause the corporation to execute bogus promissory notes.” O’Neal and Thompson, supra § 7:20.

See DiLuglio, 755 A.2d at 774. While such approach may inflate the bond beyond what the fair value of the shares may be, the Court errs on the side of caution in assuring the minority shareholder is protected in this transaction. This is consistent with the plain statutory meaning and purpose of § 7-1.2-1315, which provides that the bond must be “sufficient to assure to [Plaintiff] payment of the value of the shares.” To hold otherwise, and require a bond that may be less than the resulting fair value of the shares, would be in direct contravention to § 7-1.2-1315 and leave Plaintiff under secured and unprotected in this transaction.

IV

Conclusion

In conclusion, this Court grants Defendants’ Motion for an Election because Plaintiff’s complaint alleges oppressive conduct and waste by majority shareholders; therefore, Defendants have a right to purchase Plaintiff’s shares. Counsel shall prepare an appropriate order for entry.



RHODE ISLAND SUPERIOR COURT

Decision Addendum Sheet

TITLE OF CASE: David L. Quinn, individually and derivatively on behalf of Silvermine Bay, Inc. v. Louis Yip, et al.

CASE NO: KC 2015-0272

COURT: Kent County Superior Court

DATE DECISION FILED: December 11, 2015

JUSTICE/MAGISTRATE: Stern, J.

ATTORNEYS:

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For Defendant: Jeffrey B. Pine, Esq.; William J. Lynch, Esq.
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