Avoiding Corporate Dissolution under Section 2000 of the Corporations Code

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A **CORPORATION** can be dissolved voluntarily by holders of 50 percent or more of its shares or *involuntarily* by holders of one-third or more of its shares if certain conditions can be proved. This article deals with how both these types of dissolutions can be avoided once a dissolution proceeding has begun.

Under section 1900 of the California Corporations Code (unless noted, further Code references are to the California Corporations Code), the holders of 50 percent of the shares of a corporation (*i.e.*, NOT a majority) can commence a *voluntary* dissolution proceeding by filing a notice of dissolution with the California Secretary of State. (Cal. Corp. Code § 1900(a) (2008). Alternatively, holders of at least 33 1/3% of a corporation's stock can file a Superior Court action for *involuntary* dissolution under Section 1800. (*Id.* at § 1800(a)(2).) Section 1800 sets forth the grounds on which such an action must be based. Broadly speaking, the shareholders seeking involuntary dissolution must prove one or more of the following: (a) that the corporation has abandoned its business; (b) that the directors are deadlocked; (c) that there are two or more factions of shareholders who are deadlocked; (d) that those in control of the corporation have been guilty of persistent mismanagement, fraud and the like; (e) if there are fewer than 35 shareholders, that dissolution is reasonably necessary to protect the rights of the minority; or (f) that the term of a corporation formed for a specific period has expired. (*Id.* at § 1800(b)(1)-(6).) This article assumes that one or more such grounds exist.

Section 2000 provides a procedure that allows the shareholders opposing dissolution ("Purchasing Shareholders") to avoid the drastic consequences of dissolution by purchasing the stock of the shareholders seeking dissolution ("Dissident Shareholders"). (*Id.* at § 2000.)

The first requirement of section 2000 is that the Purchasing Shareholders (which can also be the corporation itself) give notice to the Dissident Shareholders that the Purchasing Shareholders have elected to purchase the Dissident Shareholder's shares (the "2000 Notice"). (*Id.*) The election to purchase and the 2000 Notice may be given at any time during the pendency of the dissolution proceeding (voluntary or not). (*Ronald v. 4-C's Elec. Packaging, Inc.*, 168 Cal. App. 3d 290, 303 (2d Dist. Div 7 1985).) Giving the 2000 Notice early in the proceeding has the advantage of dramatically decreasing the costs of litigation and the potential trauma to the business of the corporation because (a) of the "automatic stay" of the dissolution proceeding that is available once the election is made and (b) the appointment of a receiver can be avoided. (Cal. Corp. Code § 2000(a).) These costs can be significant and, in some cases, catastrophic. Our office recently handled a case involving an involuntary dissolution in which the costs of suit for both sides, *before* the 2000 Notice was given, exceeded $800,000. The fees and costs for both sides *after* the 2000 Notice through the confirmation of the appraisal were approximately the same amount. These costs and fees are for a company with a value of between $12.5 million (fair value) and $19 million (fair market value). On the other hand, an advantage of delaying the section 2000 election as long as possible is that it puts off the day when payment for the shares of the Dissident Shareholders has to be made.

The next step in the process requires Purchasing Shareholders to apply for a stay of the dissolution proceeding. (*Id.* at § 2000(b).) This stay is available in an action for involuntary dissolution or, in the case of a voluntary dissolution, in a separate action brought solely to obtain the stay. If the Purchasing Shareholders have given the 2000 Notice and the parties cannot agree on the price to be paid for the shares (which usually is the case), the court will stay the dissolution proceedings if the Purchasing Shareholders post a bond "with sufficient security to pay the estimated reasonable expenses (including attorneys' fees) of the moving parties if such expenses are recoverable under subdivision (c) [of Section 2000]." (*Id.)* While the amount of this bond can vary tremendously depending on the value of the corporation, in the case noted above, the court ordered a $150,000 bond, the premium for which was $15,000. Once the stay is granted, the court is required to "proceed to ascertain and fix the fair value of the shares owned by the [Dissident Shareholders]". (*Id.)* This value must be determined as of the "valuation date" (section 2000(a)) which normally is the date when (a) the dissolution proceeding was initiated in a voluntary dissolution (presumably the date of filing the requisite notice with the Secretary of State) or (b) the involuntary dissolution lawsuit was filed. (*Id.* at § 2000(f).) This date can be changed by the court on a showing of good cause. (*Id.*; *see generally, Trahan, v. Trahan*, 99 Cal. App. 4th 62 (1st Dist. Div. 2 2002).)

The fair value of the Dissident Shareholders' shares is important because that is the price that must be paid by the Purchasing Shareholders if they want to prevent dissolution of the corporation. Fair value is defined, but not too helpfully, as "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." (Cal. Corp. Code § 2000(a).) There is little appellate court guidance on the meaning of this phrase. What little there is can be found in *Trahan* (99 Cal. App. 4th at 62); *Mart v. Severson* (95 Cal. App. 4th 521 (1st Dist. Div. 2 2002)); *Ronald* (168 Cal. App. 3d at 303); *Abrams v. Abrams-Rubaloff & Assoc., Inc.* (114 Cal. App. 3d 240 (2d Dist. Div. 2 1980)); and *Brown v. Allied Corrugated Box Co., Inc.* (91 Cal. App. 3d 477 (2d Dist. Div. 3 1979)). A detailed discussion of the facts and holdings of these cases is beyond the scope of this article and the reader is directed to those cases for his or her own analysis. The essential rule of all these cases is that section 2000 requires that the Dissident Shareholders be paid substantially the same price for their shares that they would have gotten had the corporation in fact been dissolved and its assets liq-

uidated. (*Trahan*, 99 Cal. App. 4th at 75). If the appraisers determine that there is a hypothetical purchaser for the "entire business" as a going concern "in a liquidation" and this results in a higher price (which is usually the case), that is the value to be used. (*Mart*, 95 Cal. App. 4th.at 524) If not, then the corporation is valued based on what a theoretical piecemeal sale of its assets would bring. (*Id.*)

The appraisal process starts with the court appointing three disinterested appraisers. (Cal. Corp Code § 2000(c).) Experience suggests that the court will look to the parties and their counsel for recommendations. It is good practice for counsel for both sides to submit at least three pre-qualified appraisers along with their resumes so that the pool is narrowed (and strengths and weaknesses known) and the court's job facilitated. It should come as no surprise that appraisers in these types of cases do not come cheap. In the case noted above, the cost of the appraisers exceeded $300,000. To compound the expense of the appraisers and further delay the process, we discovered that the appointed appraisers were "business appraisers" who insisted on hiring additional "hard asset appraisers" to value the real estate, inventory and equipment of the corporation in question. Who pays for the appraisers is another issue that has to be dealt with, either when they are appointed or at the end of the process. Because of the unknown outcome of the appraisal process, it seems to be common practice for the courts to require the Purchasing Shareholders to "front" the appraisal costs with the ultimate allocation of those costs reserved until the process is completed.

When the court appoints the appraisers, it also is required to "prescribe the time and manner of producing evidence, if evidence is required." (*Id.*) We believe it to be good practice for counsel, when possible, to stipulate to the mechanics of this process. Such a stipulation needs to deal with when and how parties communicate with the appraisers, sharing of information given to the appraisers among the parties, the need for, and frequency of, "all hands" meetings, and other procedural issues. Obviously, the process contemplates that the appraisers will have access to as much information about the corporation as is necessary for them to do their job.

Corporations and their counsel can expect that the appraisers will want information about real and personal property assets, inventories, accounts receivable, loan balances, executory contractual commitments and myriad other financial details limited only by the complexity of the business of the corporation and the imaginations of the appraisers. The appraisers usually want to meet with representatives of the corporation to discuss various aspects of its operations, the market for its products and its financial records. Counsel for the Dissident Shareholders (or the Dissident Shareholders themselves) should reserve the right to attend any such meetings. Counsel for both sides should also anticipate frequent, and sometimes heated, exchanges over various aspects of the appraisal such as: whether the tax effect of a liquidation should be taken into account (maybe not (*see Abrams*, 114 Cal. App. 3d 240) but this is not at all clear given the changes in tax law caused by the Tax Reform Act of 1986, a topic beyond the scope of this article), whether the Dissident Shareholders are entitled to interest on the purchase (no, *Id.*), whether contracts to be performed in the future (*i.e.*, after the valuation date) should be taken into account (maybe not, *see Trahan*, 99 Cal. App. 4th at 62), and other issues.

It should be kept in mind that, unless a different valuation date is selected by the court on a showing of "good cause," the valuation date will always be retrospective, looking back to the date the dissolution proceeding commenced. This "look back" can have significant consequences if market or economic conditions have changed since the dissolution proceeding began. In the case we have been discussing, the valuation date was August 2006, but the appraisal was not confirmed until November 2008. Because of the national and California recessions, the corporation's real estate and inventory values had plummeted, forcing the corporation to buy out the Dissident Shareholders at an inflated price or face liquidation.

Once the appraisers have completed their appraisal, they file their report with the court which must then "confirm" the value determined by the appraisers. (Cal. Corp. Code § 2000(c).) This report can be a unanimous one or each appraiser can submit a separate report. (*Id.*) At this stage, the parties have an opportunity to challenge any aspect of the appraisal. This can include the overall methodology used, assumptions made, third-party valuations of specific assets (if any), accounting decisions and any other aspect of the appraisal that is considered vulnerable to attack. If the trial court determines that the value established by any one of the appraisers is supported by substantial evidence, the court *must* confirm that value. (*Trahan*, 99 Cal. App. 4th at 70; *see generally,* Ballantine & Sterling, *California Corporation Laws* §316.03[2].) Only when the court determines that none of the appraisals is supported by substantial evidence does it conduct a hearing *de novo* to establish the proper value. (*Mart*, 95 Cal. App. 4th at 535.)

When the court establishes a value of the Dissident Shareholders' shares, it then orders that payment for those shares be made within a specific time or, in the alternative, that if payment is not timely made, that the corporation be wound up and dissolved. (Cal. Corp Code § 2000(c).) There are no guidelines in section 2000 or any of the reported cases regarding when payment should be made, but we believe counsel should expect the payment date to be set sometime within 30 to 45 days after the value is set.

As noted, if the price for the shares is not paid within the time established, the court must order the corporation to be wound up and dissolved. (*Id.*) If this occurs, the court can also appoint a receiver to oversee the winding up and dissolution. (*Id.* at §§ 1803, 1904.)

If either the Purchasing Shareholders or the Dissident Shareholders are dissatisfied with the courts determination of "fair value" they may appeal. (*Id.* at § 2000(c) ("Any shareholder aggrieved by the action of the court may appeal therefrom.").) Although on its face the statute limits the right to appeal to a "shareholder," presumably, if the corporation itself is the Purchasing Shareholder, it too can appeal. As with most of section 2000, there is no appellate court guidance on this or many other points that may arise on appeal.

It should be obvious from the foregoing discussion of section 2000 that the process is lengthy (despite being referred to as "summary" in *Abrams*, 114 Cal. App. 3d at 248) and shockingly expensive with legal fees, appraisal fees, accounting fees and fees of other third parties whose expertise is needed or desired by any of the parties. Counsel should not advise making a section 2000 election without a thorough understanding of the procedural aspects of section 2000 and a complete evaluation of the likely costs of such a proceeding. As with most cases, if there is some reasonable basis for the parties to agree on a price and time and terms of payment, that is the wisest course to follow.

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