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3/14/2018 11:48 AM
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IN THE CHANCERY COURT FOR THE STATE OF TENNESSEE
TWENTIETH JUDICIAL DISTRICT, DAVIDSON COUNTY

TERRELL K. RALEY, individually, and on behalf of 4 POINTS HOSPITALITY, LLC,	)	
Plaintiffs,	)	
VS.	)	**NO. 16-196-BC**
CEES BRINKMAN and BRINKMAN HOLDINGS, LLC,	)	
Defendants,	)	
AND	)	
CEES BRINKMAN, individually, and on behalf of 4 POINTS HOSPITALITY, LLC,	)	
Counterclaimant,	)	
VS.	)	
TERRELL K. RALEY, AMARANTH HOSPITALITY GROUP, LLC,	)	
Counterdefendants.	)	

MEMORANDUM AND ORDER GRANTING "RALEY'S MOTION TO DETERMINE MEANING AND COMPONENTS OF 'FAIR VALUE' UNDER TENN. CODE ANN. § 48-249-506(3) AND AS APPLIED TO THIS CASE"

The status of this case is valuation of Plaintiff Raley's 50% LLC membership interest, pursuant to Tennessee Code Annotated section 48-249-506(3)(B)(ii), in a buyout by the other 50% member, Defendant Brinkman.

The buyout is the relief that was sought by Defendant Brinkman upon the Court awarding Defendant Brinkman damages and attorneys fees and terminating the LLC membership of Plaintiff Raley for breach of fiduciary duty, breach of contract, and that it is not reasonably practicable for the parties to carry on business with each other.

Presently before the Court is the motion of Plaintiff Raley for a ruling of law that the "fair value" of Plaintiff Raley's LLC membership interest, as that term is used in Tennessee Code Annotated section 48-249-506(3)(B)(ii), should not be reduced for lack of control or lack of marketability, and that the corporate income tax rate should not be used as an adjustment in connection with future income stream and the capitalization rate. These reductions have been applied by Defendant Brinkman's expert in determination of the fair value of Plaintiff Raley's LLC membership pursuant to Tennessee Code Annotated sections 48-249-505(c) and 506(3)(B)(ii). Application of the discounts and corporate tax rate creates a significant difference in value. When these reductions are applied, the membership value is about $1,000,000. Without the reductions, the membership value is $2,423,355.

The Court has studied the briefing of Counsel and cases cited therein, and Defendant's expert affidavit of Certified Public Accountant and Certified Valuation Analyst Thomas M. Price, and has read *University of Pennsylvania Journal of Business Law* "Discounts and Buyouts In Minority Investor LLC Valuation Disputes Involving Oppression or Divorce," 13 U. Pa. J. Bus. 607 (2011), Sandra K. Miller, Professor, J.D.,

LL.M. Ph.D. ("*Journal Article*") and the noteworthy cases cited in the article, and has reviewed the findings of fact and conclusions of law from the Phase 1 trial of this case. From the foregoing the Court concludes that in this case it is able to summarily decide, without further proof and expense, that the three reductions[1] Defendant Brinkman asserts should be applied in arriving at the fair value of Plaintiff Raley's LLC membership interest—lack of control, lack of marketability, and the application of a corporate tax rate—should not be applied.

In arriving at this decision, the Court begins with its conclusion as a matter of statutory interpretation that the term "fair value" of a terminated membership interest in an LLC as used in Tennessee Code Annotated section 48-249-506(3)(B)(ii) does not always preclude the application of discounts for lack of marketability or control.[2]

[1] Plaintiff Raley characterizes the 38% corporate tax rate as a discount. Defendant Brinkman objects to that characterization and asserts it is an expert valuation method and therefore a question of fact that should not be ruled upon absent an evidentiary hearing.

[2] Neither the Court nor Counsel for either party have located any Tennessee case law defining "fair value" under section 48-249-506(3) in the context of judicial termination of an LLC interest. As noted by Defendant Brinkman's Counsel "Courts in other jurisdictions have held that the term 'fair value' is an inherently ambiguous term. *See, e.g., Brown v. Arp & Hammond Hardware Co*., 141 P.3d 673, 679 (Wyo. 2006); *Pueblo Bancorporation v. Lindoe, Inc*., 63 P.3d 353, 359 (Colo. 2003); *Columbia Management Co. v. Wyss*, 765 P.2d 207, 210 (Ore. Ct. App. 1988)." *Brinkman's Response in Opposition to Raley's Motion to Determine Meaning and Components of "Fair Value" Under Tenn. Code Ann. § 48-249-506(3) and as Applied to This Case*, filed February 5, 2018 at 2.

In so concluding the Court takes into account that the statute directs the Court to consider "relevant evidence" and then provides an inexhaustive list of considerations.

> § 48-249-506. Determination of fair value
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> If an LLC is required or elects to purchase a membership interest at fair value under § 48-249-505, then:
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> * * *
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> (3) Judicial determination of fair value.
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> (B) In a proceeding brought to determine the fair value of a membership interest in an LLC, the court:
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> (ii) In the absence of any such governing terms in the LLC documents, shall determine the fair value of the membership interest, considering, among other relevant evidence, the going concern value of the LLC, any other agreement among any members fixing the price or specifying a formula for determining value of membership interests for any other purpose, the recommendations of an appraiser appointed by the court, if any, the recommendations of any of the appraisers of the parties to the proceeding, and any legal or financial constraints on the ability of the LLC to purchase the membership interest . . . .

Tenn. Code Ann. § 48-249-506(3)(B)(ii). This statutory direction indicates that there is no one set definition for "fair value" and that the determination is on a case-by-case basis.

Also informative is the Legislative change from the term "fair market value," used in the previous LLC statute in relation to a buyout of a withdrawing or terminating member's interest in an LLC. Previously, Tennessee Code Annotated section 48-216-101(e) provided,

> If the business and existence of the LLC are continued, any withdrawing or terminating member, whether such withdrawal or termination was wrongful or otherwise, is entitled to receive, subject to subsection (d), the lesser of the fair market value of the withdrawing or terminating member's interest determined on a going concern basis or the fair market value of the withdrawing member's interest determined on a liquidation basis.

With the passage of the Revised LLC Act, the Legislature changed the more restrictive and defined "fair market value" going concern or liquidation basis for valuation to the present undefined, flexible text of the statute of "fair value" using "relevant evidence."

Based upon all of these sources, the Court concludes that the text of the statute does not categorically preclude the use of discounts in arriving at the fair value of a judicially terminated LLC membership and that the use of discounts is dependent upon the circumstances of the case.

Turning then to the particulars of this case, the Court begins with Defendant Brinkman's position that Plaintiff Raley's membership interest should be discounted for lack of control. The relevant facts on this are undisputed, enabling the Court to summarily rule on this issue without an evidentiary hearing.

Plaintiff Raley holds a 50% membership interest in the LLC as does Defendant Brinkman, and the Court has awarded Defendant Brinkman, in the Phase 1 litigation, the relief he sought of becoming the 100% owner of the LLC by buying the Raley interest. Under these circumstances, the case law cited by Plaintiff's Counsel informs the Court "[t]he rule justifying the devaluation of minority shares in closely held corporations for their lack of control has little validity when the shares are to be purchased by someone who is already in control of the corporation. In such a situation, it can hardly be said that the shares are worth less to the purchaser because they are noncontrolling." *Brown v. Allied Corrugated Box Co.*, 91 Cal. App. 477, 486 (1979). Similarly, in *Charland v. Country View Golf Club, Inc.*, 588 A.2d 609, 612 (R.I. 1991), the Rhode Island Supreme Court ruled that "[w]hen a corporation elects to buy out the shares of a dissenting shareholder, the fact that the shares are noncontrolling is irrelevant." The Montana Supreme Court summarizes that "[t]he majority of courts addressing the issue of minority discounts has held that discounts should not be taken when determining fair value of minority shares sold to another shareholder or to the corporation." *Hansen v. 75 Ranch Co.*, 957 P.2d 32, 41 (Mont. 1998).

Additional persuasive reasoning is found in the *Journal Article* addressing the varying contexts of, on one hand, cases of oppression, and on the other divorce cases.

> In spite of the differences between the squeeze-out and divorce settings, there are still some significant objections to the minority discount that apply with equal force in both the oppression and divorce contexts. The minority discount injects unwarranted uncertainty and a lack of predictability in both

> oppression and divorce LLC cases. Also, regardless of whether the valuation occurs in a squeeze-out or a divorce, an adjustment for the minority discount still makes little sense when the business itself does not have a market and is unlikely ever to be sold. Thus, although a number of arguments against the minority discount have little application to the divorce context, there are still some important reasons that support a prohibition of the minority discount in some divorce settings.

Journal Article at 637.

Consistent with the above case law and the *Journal Article*, the Court concludes that a discount for lack of control is inapplicable to this case because the buyout is by someone who will be in control of the LLC and therefore Plaintiff Raley's membership interest cannot be said to be worth less because they are noncontrolling.

As to marketability, Defendant Brinkman argues that the buyout of a closely held LLC presents the issue of illiquidity because there is a limited number of buyers and not a ready market, and therefore a lack of marketability discount is appropriate. Defendant Brinkman's expert has opined that a 25% adjustment should be applied.

Yet, as provided in Plaintiff's briefing and citations therein, and as explained in the *Journal Article*, reductions for lack of marketability are not usually applied in LLC membership valuation. There must be some extraordinary circumstance, such as loss of a key person, to discount for lack of marketability.

> The pervasive weight of authority is clearly to disregard the minority discount in oppression, dissenters, and even ordinary dissociation case contexts. Furthermore, given the ALI and RUPA's approach to the marketability discount, it makes sense to retain a general prohibition on the

> marketability discount in such settings. The double-counting problem, the under-compensation risk, and the market irrelevancy issue provide compelling policy reasons to prohibit the marketability discount in the usual LLC buy-out or dissenters case, and possibly in some, if not all divorce proceedings.

Journal Article at 642-43. The Defendant has posited no extraordinary circumstances in this case for discounting for lack of marketability.

The Court further concludes as a matter of law that a reduction for lack of marketability as a consequence of wrongdoing by Plaintiff Raley is inappropriate. The Court adopts Plaintiff Raley's interpretation of the statute that, "The valuation proceeding before the Court is not a continuation of the trial. It is a wholly separate statutory proceeding for the determination of the fair value of Raley's membership interest. . . . The Court has already made its rulings on the parties' allegations of wrongful conduct. The Court has already awarded both parties damages as a remedy for those rulings. The sole issue to be determined in this proceeding is the "fair value" of Raley's membership interest. Wrongdoing is not to be considered. In fact, Tenn. Code Ann. § 48-249-505(c) expressly provides that ***"regardless of whether such termination of membership was wrongful***, any member whose membership interest has so terminated . . . is entitled to receive from the LLC the fair value of the terminated membership interest . . .." *Raley's Reply* at 1-2 [emphasis in original].

As explained in the *Journal Article*, wrongful conduct should be addressed, as was done in this case, through damages awards and attorneys fees, and should not be addressed in valuation.

> An alternative approach might be to handle instances of bad faith/misconduct through the imposition of punitive damages and/or to permit the award of court costs and attorney's fees. Counterclaims for tortious conduct might also be justified in certain extreme cases. Addressing misconduct through punitive damage awards, the award of court costs, and/or through counterclaims may be more honest and transparent than using a discount factor as a "catch-all" adjustment to punish one of the parties.
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> * * *
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> Also, in an equitable proceeding, some judicial discretion in the interests of fairness and equity may be appropriate regarding payment terms, etc. However, a broad exception to the prohibition on the marketability discount for "extraordinary circumstances" is not recommended because it would reintroduce uncertainty in the LLC valuation process. It is true that the objectives of fairness and equity should not be overlooked in connection with valuations arising in oppression cases or divorce--"leaving fairness out of the law is a little like asking Mrs. Lincoln if she otherwise liked the show." However, if there has been bad faith, a breach of contract, or tortious conduct, it should be dealt with straightforwardly, and an award of compensatory and/or punitive damages should be sought.

Journal Article at 645–47.

As to application of a 38% corporate tax rate to arrive at the fair value of Plaintiff Raley's membership interest, Defendant Brinkman asserts this is not a discount but an expert valuation method appropriate for fact finding that should not be ruled upon absent an evidentiary hearing. The premise of Defendant Brinkman's expert is that application

of the 38% corporate tax rate is a necessary adjustment to insure an accurate comparison for the components of the LLC's expected income stream and capitalization rate.

> The affidavit of Thomas M. Price, CPA establishes that standard approaches and methods of valuation include applying a 38% corporate tax rate to the historical income before taxes of 4 Points, as was done by FrasierDeanHowardCPAs ("FraiserDean") in its Calculation of Value upon which Brinkman based his "fair value" offer to Raley. (T. Price Aff., ¶ 5). It is not a discount, as Raley terms it. (*Id.*). As explained by Mr. Price, it was a necessary adjustment employed by FrasierDean to ensure that 4 Points' expected future income stream and the capitalization rate calculated by FrasierDean, the components of which are all based on after-tax values or after-tax income data, were on an "apples-to-apples" basis. (*Id.*, ¶¶ 6-19). Thus, Raley's tax complaint does not present a question of law; it is simply an attack on the valuation methodology and computations of FrasierDean, which is a question of fact.
>
> Raley will have an opportunity to present countervailing expert testimony to support his tax argument if he is able to do so. To date, however, Raley has provided the Court with only unsubstantiated lawyer argument, which Mr. Price's affidavit establishes is in error and demonstrates a lack of understanding of standard approaches and methods of valuation. (*Id.*, ¶ 5). And, the only legal authority cited by Raley, *Gross v. Commissioner*, 272 F.3d 333 (6th Cir. 2001), involved Sixth Circuit review of the tax court's assessment of the fair market value of gifted stock for federal income tax purposes. Not only does the context of *Gross* make it inapplicable to this case, even the *Gross* court acknowledged that "[t]his appeal really presents a battle of the experts on the question of how the stock of a closely held S Corporation . . . should be valued." *Id*. at 351. As a result, the Sixth Circuit applied its "clear error" standard for reviewing findings of fact by the tax court. *Id.* at 342-343. For these reasons, Raley's tax complaint should be rejected.

Brinkman's Response at 9-10. Respectfully, the Court comes to a different conclusion than that asserted by Defendant Brinkman.

The Court adopts the authorities cited by Plaintiff Raley and reasoning that "no entity level tax should be applied in the valuation analysis for a non-controlling interest in an electing S corporation, absent a compelling demonstration that independent third parties dealing at arms-length would do so as part of a purchase price negotiation." *Valuation of Non-Controlling Interests in Business Entities Electing to be Treated as S Corporations for Federal Tax Purposes: A Job Aid for IRS Valuation Analysts*, by Representatives of the Large Business and International Division NCR Industry, Engineering Program and the Small Business/Self-Employed Division Estate and Gift Tax Program, October 29, 2014. In so concluding, the Court rests primarily on the reasoning that the LLC elected to be taxed as an S-corporation. As a nontaxable pass-through, the LLC does not pay federal income taxes on their entity level earnings; the taxes are paid by the individual owners on their own returns. Thus, even for the purpose of establishing a correlation, as asserted by Defendant Brinkman's expert, the Court nevertheless concludes as a matter of law this would not be appropriate. The Court also, to a lesser extent, is guided by *Gross v. Comm'r IRS*, 272 F.3d 333, 347 (6th Cir. 2001) although, as pointed out by Defendant Brinkman, the context of *Gross* is the fair market value of gifted stock for federal income tax purposes, and it is not on point but only analogous.

It is therefore ORDERED that Plaintiff *Raley's Motion to Determine Meaning and Components of "Fair Value" Under Tenn. Code Ann. § 48-249-506(3) and as Applied to This Case* is granted, and the Court concludes as a matter of law that neither a lack of control or marketability discount nor 38% corporate tax adjustment shall be applied in valuing Plaintiff Raley's membership interest.

Further, as provided in the December 22, 2017 *Order Setting Deadlines for Disposition of Preliminary Motions on Phase 2 Fair Value Determination and Payment Terms*, the Court shall conduct a telephone conference to set remaining deadlines to complete the case.

It is ORDERED that by March 23, 2018, Counsel shall contact the Docket Clerk, Mrs. Smith (615-862-5719), on their availability for a telephone conference on the following dates and times:

— March 27, 2018 at 12:15
— April 2, 2018 at noon
— April 4, 2018 at noon.

/s/ Ellen Hobbs Lyle
ELLEN HOBBS LYLE
CHANCELLOR
TENNESSEE BUSINESS COURT
PILOT PROJECT

cc by U.S. Mail, email, or efiling as applicable to:
Seth McInteer
Howell O'Rear
W. Scott Sims
Michael O'Neill
D. Gil Schuette