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Summary of American Ethanol v. Cordillera Fund, 127 Nev. Adv. Op. No. 13

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American Ethanol, Inc. v. Cordillera Fund, L.P., 127 Nev. Adv. Op. No. 13 (May 5, 2011)[1]

CORPORATE LAW – ASSIGNING FAIR VALUE OF STOCK

Summary

The Court reviews an appeal from a district court decision in a corporation action.

Disposition/Outcome

The Court held that the "fair value" of the shares of stock in question was $3 per share under NRS 92A.300 -500 and affirmed the lower court's decision. The Court further held that both parties shared the burden of proof to demonstrate the "fair value" of the shares of stock.

Facts and Procedural History

Cordillera Fund, L.P. ("Cordillera") acquired a total of 583,334 shares of series B convertible preferred stock in American Ethanol, Inc. ("American Ethanol") at $3 per share in 2006. In 2007, American Ethanol formalized a merger with AE Biofuels, Inc. ("AE"). American Ethanol informed its stockholders of the merger and Cordillera, as a stockholder, notified American Ethanol of its intent to dissent. After the merger, Cordillera demanded payment of the "fair value" of the American Ethanol stocks it owned under NRS 92A.440, the dissenters' rights statute. American Ethanol refused to pay and Cordillera sued for declaratory and injunctive relief, asking the court to affirm its right to receive payment and enjoin American Ethanol to comply with Nevada's dissenters' rights statutes, including NRS 92A.440.

The district court affirmed Cordillera's right to receive payment. The parties proceeded to trial to determine the "fair value" of the stocks. Neither party was able to obtain an appraisal of the stocks' value. However, American Ethanol submitted as evidence of their "fair value" the stocks' book value, at $0.15 per share, while Cordillera submitted three SEC documents to support their estimate of "fair value" at $3 per share and one document affirming that the offering price of the stocks was $3 per share on the date of the merger. The district court found, on preponderance of the evidence, that the offering price of the stocks was the most reliable evidence of "fair value" and found for Cordillera to that amount, plus interest.

American Ethanol and AE appealed, arguing that Cordillera had the burden of proof to determine the "fair value" of the stocks, and that the district court abused its discretion in finding for Cordillera because Cordillera had not met its burden.

Discussion

What Evidence Of "Fair Value" May A Court Consider?

Nevada's dissenters' rights statutes are meant to protect minority shareholders' interests from mergers. Minority shareholders who dissent to a merger are entitled to the fair value of their shares.[3]

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[3] Cohen v. Mirage Resorts, Inc., 119 Nev. 1, 10, 62 P.3d 720, 726-27.

Nevada statutes do not explicitly define "fair value." However, the statutes do give some parameters for determining fair value. First, NRS 92A.320 (2008), which has since been amended, but which the Court relied on because it was in effect while this case was pending, states that "fair value" is "the value of the shares immediately before the effectuation of the corporate action to which [the stockholder] objects, excluding any appreciation or depreciation in anticipation of the corporate action unless exclusion would be inequitable."[4] The Court, in a footnote, noted that the newly amended NRS 92A.320 (2009), is not more helpful.

Next, the official comments to the 1984 Model Business Corporation Act, upon which Nevada's dissenters' rights statutes are based on, state that individual courts are to construct their own rules for finding "fair value."[5] A federal case was not more helpful, affirming that "fair value" is not defined by Nevada statutes.[6] Next, the Court cited a law treatise that stated that most courts consider "all relevant factors" to determine dissenters' share value.[7]

Next, the Court turned to its own case law. First, *Southdown, Inc. v. McGinnis*, 89 Nev. 184, 188-90, 510 P.2d 636, 639-40 (1973) states that "fair value" is usually the "intrinsic value of the dissenting shareholder's interest determined from the assets and liabilities of the corporation considered in the light of every factor bearing on value." The Court again cited *Steiner* for the proposition that "any… factor bearing on value" can be considered.[8]

Finally, other states who have also adopted major provisions of the Model Act have created criteria to determine fair value: (1) the trial court may rely on proof of value by any technique that is generally accepted in the relevant financial community, (2) the trial court should consider all relevant factors, but (3) the value must be fair and equitable to all parties.[9]

Which Party Has The Burden Of Proving The "Fair Value"?

Nevada statutes do not expressly state which party has the burden of proof. Some courts place the burden of proof on the corporation, others on the stockholder, and others on neither. The Court adopted Delaware's approach because it reflects economy and fairness, and because Delaware statutes, like Nevada's, require the court to make an independent judgment of fair value.[10] In Delaware, "both sides have the burden of proving their respective valuation position by a preponderance of evidence."[11] "Even if one side fails to satisfy its burden, the Court is not free to accept the competing valuation by default, but must use its own independent judgment to determine fair value."[12]

[4] American Ethanol, Inc. v. Cordillera Fund, L.P., 127 Nev. Adv. Op. No. 13 (May 5, 2011) (quoting NRS 92A.320 (2008)).
[5] 3 Model Bus. Corp. Act Ann. § 13.01 cmt. 3 (3d ed. 1984).
[6] Steiner Corp. v. Benninghoff, 5 F. Supp. 2d 1117, 1123 (D. Nev. 1998).
[7] Ferdinand S. Tinio, Annotation, *Valuation of Stock of Dissenting Stockholders in Case of Consolidation or Merger of Corporation, Sale of Its Assets, or the Like*, 48 A.L.R.3D 430 § 3(a) (1973).
[8] *Steiner*, 5 F. Supp. 2d at 1126.
[9] Advanced Commc'n Design v. Follett, 615 N.W.2d 285, 290 (Minn. 2000).
[10] NRS 92A.490(a) (the "corporation shall… petition the court to determine the fair value"). NRS 92A.490(5)(a) ("dissenter … is entitled to a judgment [f]or the amount, if any, by which the court finds the fair value of the dissenter's shares").
[11] M.G. Bancorporation, Inc. v. Le Beau, 737 A.2d 513, 520 (Del. 1999).
[12] Montgomery Cellular Holdings Co. v. Dobler, 880 A.2d 206, 221 (Del. 2005).

Did The Trial Court Abuse Its Discretion By Not Relying On The *Steiner* Test?

The trial court did not abuse its discretion. Appellants argued that the trial court was required to evaluate "fair value" under the four factors set forth by *Steiner*: (1) the pre-merger market value of the shares,[13] (2) the pre-merger enterprise value of the corporation as a whole, (3) the pre-merger net asset value of the corporation, and (4) any other factor bearing on value.[14] However, neither party was able to supply enough evidence for the trial court to apply the Steiner factors. Therefore, the trial court was justified in using its own methodology to determine the "fair value" of the stocks. The Court found that the documents that Cordillera supplied, consisting of the purchase price of the stocks and the three SEC documents, was sufficient to find that the "fair value" of the stocks was $3 per share.

Conclusion

Both parties have the burden of proving their own proffered "fair value" by preponderance of the evidence. If no party is able to meet its burden of proof, the court must make its own independent value determination.

[13] Steiner Corp. uses the pre-merger market value of the shares, discounted for illiquidity. However, Nevada statutes forbid courts from taking account of the stocks' marketability, requiring some departure from the Steiner test.

[14] Steiner Corp. v. Benninghoff, 5 F. Supp. 2d 1117, 1123 (D. Nev. 1998).