Feature

KEY POINTS

- The court has a wide discretion when making a share purchase order under s 996 of the Companies Act 2006 which extends to every aspect of the fixing of the price.
- Two of the most important matters for the court to consider are: (i) whether to apply a minority discount; and (ii) what valuation date to select.
- Whilst the starting point is that the shares should be valued as at the date of judgment, an earlier date may be required, out of fairness to the petitioner – or to ensure fairness to the party being ordered to purchase the petitioner's shares.
- In either case, the court should consider whether to award the petitioner quasi-interest on the purchase price from a date prior to the date on which his shares are purchased.

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One way bets and straining at gnats: fixing a fair valuation date in unfair prejudice petitions

In this article Daniel Lightman QC examines two of the key issues which a court must consider when exercising its discretion to determine the price payable under a share purchase order, a minority shareholder's most common remedy for unfairly prejudicial conduct: whether to apply a minority discount, and what valuation date to select. The article considers in particular the factors which may lead the court to order the shares to be valued as at a date (potentially considerably) prior to the date of judgment, sometimes out of fairness to the petitioner but at other times so as to ensure fairness to the party being ordered to purchase the petitioner's shares. The article also explores the circumstances in which a petitioner can be awarded quasi-interest on the purchase price from a date prior to the date on which his shares are purchased.

SECTION 994 PETITIONS: A MINORITY SHAREHOLDER'S PRINCIPAL PROTECTION

Often, the principal protection for a minority shareholder is his or her ability to present (or to threaten to present) a petition under s 994 of the Companies Act 2006 (2006 Act). In order to petition the court successfully, he needs to show one of two things: either that the affairs of the company of which he is a shareholder are being or have been conducted in a manner unfairly prejudicial to the interests of all or some of the company's members (including him); or that an actual or proposed act or omission of the company is or would be so prejudicial.

The minority shareholder's reward for satisfying the court that his petition is well founded is that he thereby unlocks the court's jurisdiction under s 996(1) of the 2006 Act to "make such order as it thinks fit for giving relief in respect of the matters complained of". The court's powers under s 996(1) are extremely wide, and are not limited by the illustrations set out in s 996(2) of the type of order which the court may make, since that sub-section is specifically stated to be "[w]ithout prejudice to the generality of subsection (1)".

If the court makes a finding of unfair prejudice within the meaning of s 994 of the 2006 Act, it has then to go on to consider the whole range of possible remedies provided for in s 996 and choose the one(s) (if any) which in its assessment is or are most likely to remedy the unfair prejudice and to deal fairly with the situation which has occurred. In the exercise of its wide discretion, the court must take into account all of the circumstances of the case.

SHARE PURCHASE ORDERS

However, the order most commonly made by the court is that set out in s 996(2)(e), namely "provide for the purchase of the shares of any members of the company by other members or by the company itself and, in the case of a purchase by the company itself, the reduction of the company's capital accordingly". "Ultimately, in a breakdown of relations between a majority and a minority shareholder", as HH Judge David Cooke (sitting as a High Court judge) pointed out in *Harborne Road Nominees Ltd v Karvaski* [2012] 2 BCLC 420, at [27], "the solution is likely to be that the minority shareholder must exit the company, or be offered the opportunity to do so on fair terms …" It should be noted that notwithstanding the wording of s 996(2)(e) the parties against whom share purchase orders can be made are not limited to other shareholders or the company itself. Relief can be granted under s 996 against anyone who is responsible for the unfairly prejudicial conduct, even if they are not (and never have been) either directors or shareholders of the company: see my article 'Unfair Prejudice Petitions: Long-range Missiles for Minority Shareholders' (2013 11 JIBFL 694).

For the purpose of establishing the price payable under a buyout order, the courts adopt a flexible attitude to share valuation. Notably, actual share values can be adjusted to reflect the effect on the company of all or any wrongs which the respondents have committed against it: *Re Annacott Holdings Ltd* [2013] 2 BCLC 567, at [26] (Arden LJ).

The court's wide discretion extends to every aspect of the fixing of the price for a share purchase order. As Lord Brodie stated in the Scottish case of *Gray v Braid Group (Holdings) Ltd* [2016] CSIH 68, at [96]:

> "The court's wide discretion has been held to extend to the precise terms in which it might choose to fashion a purchase order in order to make it fair and equitable, having regard to all the circumstances, including the conduct of the petitioner … That must include fixing the price."

In particular, as Lord Menzies pointed out in the same case, the court is entitled to assess the effect of the unfairly prejudicial conduct which it has found to obtain, and to consider issues of proportionality.

MINORITY DISCOUNT?

One matter which the court must decide when making a share purchase order is whether to apply a minority discount to the valuation of the petitioner's shares. Since a minority discount can be substantial, this issue is often highly significant economically. Whilst it is clear that no discount should ordinarily be applied in relation to a quasi-partnership company, where the company is not (or is no longer) a quasi-partnership the authorities are divided as to the circumstances in which a minority discount should be applied. This is because two relatively recent first-instance decisions – *Re Blue Index Ltd* [2014] EWHC 2680 (Ch) and *Re Addbins Ltd; Ashdown v Griffin* [2015] EWHC 3161 (Ch) – have sought to undermine the previously-understood general rule that a minority discount should be applied in the valuation of non-quasi-partnership companies. Whilst it is beyond the scope of this article to consider this important issue in any detail, it is suggested that the principles which it would be appropriate for the courts to set down in relation to the application of a minority discount may be summarised as follows:

- If the court is satisfied that a s 994 petition is well founded, it may make "such order as it thinks fit for giving relief in respect of the matters complained of", including a share purchase order. The court should, however, be mindful of the fact that it is no part of the purposes of ss 994 and 996 to enable a shareholder to get more for his shares than he would have been able to obtain in the absence of unfair prejudice, save where, and to the extent that, such unfair prejudice has depressed the value of his shares.
- In the case of a quasi-partnership, the general rule is that no minority discount should be applied to a share purchase order made in respect of the shares of a quasi-partner, but:
  - the court may nonetheless exercise its discretion to apply a minority discount, for example where a buyout of the petitioner's shares at their full, undiscounted, value would be disproportionate to any prejudice suffered; and
  - a minority discount should be applied where: (i) the petitioner has so acted as to deserve his exclusion from the company; or (ii) by the time the petition is presented the company has ceased to be a quasi-partnership.
- Where the company is not a quasi-partnership, the petitioner's shares should, save in exceptional circumstances, be valued subject to a minority discount.
- Exceptional circumstances may arise where all three of the following conditions apply:
  - the petitioner purchased his shares at a non-discounted price;
  - he would be entitled to an order for the just and equitable winding up of the company; and
  - he pleads and proves that the conduct of the respondents which is found to be unfairly prejudicial was influenced by a desire to buy out or worsen the position of the minority.

DATE OF VALUATION

Another important element of the court's determination of the terms of a share purchase order is the date of valuation. Whilst the overriding requirement is that the date of valuation should be fair on the facts of the particular case, the starting point for the date of valuation of shares for the purposes of a buy-out order under s 996 is the date of judgment. This is because, as Nourse J stated in *In re London School of Electronics Ltd* [1986] Ch 211, 224:

> "*Prima facie* an interest in a going concern ought to be valued at the date on which it is ordered to be purchased."

Nonetheless, the court is free to choose such date as it considers most appropriate and just in the circumstances of the case. In particular, as Blackburne J stated in *Re Abbington Hotel Ltd* [2012] 1 BCLC 410, at [123], the date which the court selects should be that which best remedies the unfair prejudice held to be established.

AN EARLIER DATE OUT OF FAIRNESS FOR THE PETITIONER

In many cases, a minority shareholder complains that the value and future prospects of the company (and hence of his shareholding in it) has been significantly diminished by the unfairly prejudicial conduct of which he complains. The majority shareholder may have siphoned off the company's business – or a valuable business opportunity – to a newco and/or paid himself excessive remuneration. Out of spite, the respondent may have deliberately run the business down with a view to defeating the petitioner's claim. By the time the petition is presented, or tried, the company may be in administration or liquidation. By removing him as a director and/or denying him access to information about the company, the respondent may have excluded the petitioner from any meaningful participation in the business or knowledge of what is or has been going on in it.

As a result, the majority of the reported judgments which consider the date of valuation focus on what date would be most advantageous to the petitioner, or, put another way, what valuation date would most appropriately compensate him for the unfair prejudice which he has suffered.

Fairness to the petitioner sometimes requires a valuation to relate back to a date earlier than the date of the petition. As Lawton LJ stated in *Re a Company (No. 002612 of 1984)* (1986) 2 BCC 99495, 99501:

> "If, for example, there is before the court evidence that the majority shareholder deliberately took steps to depreciate the value of shares in anticipation of a petition being presented, it would be permissible to value the shares at a date before such action was taken."

As Robert Walker LJ pointed out in *Profinance Trust SA v Gladstone* [2002] 1 WLR 2014 (*Profinance*), at [61], there are a number of other situations in which an early valuation date should be ordered out of fairness for the petitioner. These include

where "there has been a sea change in the company's business since the petitioner last associated himself in any way with the company" (as Peter Gibson LJ stated in *Re DR Chemicals Ltd* (1989) 5 BCC 39, 54), where the company has been deprived of its business or has been reconstructed or its business has changed significantly, so that it has a new economic identity (*Re OC (Transport) Services Ltd* [1984] BCLC 251, 258), where a company which has since become insolvent was solvent at the time the petitioner was expelled from the business (*Re Via Servis* [2014] EWHC 3069 (Ch), [84]), or where there is a general fall in the market after the petition is presented (*In re Cumana Ltd* [1986] BCLC 430).

More generally, as Proudman J stated in *Re Phoenix Contracts (Leicester) Ltd* [2010] EWHC 2375 (Ch), at [150], "it may be appropriate to specify an early valuation date where it is simply unclear whether the respondent's conduct after the date of unfairly prejudicial conduct has caused the diminution in the value of the shares, on the basis that it is unfair for the petitioner to assume the burden of the risk".

In *Profinance*, at [61(v)], Robert Walker LJ stated that when deciding the appropriate valuation date the court could be heavily influenced by the parties' conduct in making and accepting or rejecting offers either before or during the course of the proceedings. In *Re Foundry Miniatures Ltd* [2017] 2 BCLC 489, HH Judge David Cooke (sitting as a High Court judge) noted, at [94], that if the respondents had made a fair offer and the petitioner had turned it down, it would have been much harder for the petitioner to say that in all fairness he should be bought out at an early date.

NO "ONE-WAY" BET FOR THE PETITIONER

However, it is important to bear in mind that the court's task is to ensure that the date of valuation should be fair to all parties. As HH Judge Pelling QC (sitting as a High Court judge) explained in *Re Pedersen (Thameside) Ltd* [2018] BCC 58, at [12], the court must consider whether the relief which the petitioner seeks is proportionate to the unfairly prejudicial conduct of which he complains, and which the court decides has been made out. The remedy must be proportionate to the unfair prejudice found. And as Lewison J pointed out in *Hawkes v Cuddy* [2008] BCC 390, at [246], the exercise of the jurisdiction under s 996 is not a punishment for bad behaviour.

Accordingly, a petitioner is not entitled to what Robert Walker LJ in *Profinance* described as a "one-way bet". A petitioner should not be permitted to hedge his bets against the possibility of a diminution in the company's value prior to a share purchase order being made.

In *Re CF Booth Ltd* [2017] EWHC 457 (Ch), the petitioners contended that their shares should be valued as at a date more than three years before the presentation of their petition. Rejecting that argument, and instead directing that their shares be valued as at the date on which they presented the petition, Mark Anderson QC (sitting as a deputy High Court Judge) stated that "[t]hough thoroughly dissatisfied with the absence of dividends, they retained their investment instead of taking the risk of litigating to sell it. To that extent, they chose to remain as investors and I think it would be wrong to take a date earlier than the date of the petition to relieve them retrospectively of the risk that every investor takes, of a fall in the value of the investment".

A similar approach was taken in the BVI case of *CH Trustees SA v Omega Services Group Limited* BVIHC (COM) 2015/0037, where Wallbank J [Ag] stated that in determining the valuation date he must "bear in mind the circumstances that have led to an order for sale to be made". Whilst the specific unfairly prejudicial act which triggered the court's discretion had been carried out on 10 April 2015, the claimant did not seek to move the court to maintain the status quo to prevent further unfairly prejudicial acts and whilst it issued proceedings in 2015, it was only on 8 February 2016 that it filed the amended claim form on the basis of which the proceedings moved forward. Wallbank J decided that 8 February 2016 was the appropriate valuation date, because that date "formally marks the Claimant's protest at the unfairly prejudicial conduct carried out" and was "a date which maintains an even balance between the parties and it cuts both ways".

In the Hong Kong case of *Re Maxtop International Investment Ltd* [2014] 4 HKLRD 416, Deputy Judge Stewart Wong SC rejected the petitioner's contention that his shares should be valued as at the date of presentation of the petition, and instead ordered a share valuation as at the date of his order. In that case, the petitioner argued that the buyout order should be made on the basis that he was entitled to a certain sum of money. That issue therefore had to be resolved by the court in the petition before the petitioner's shares could be valued. The petitioner failed on this issue. Accordingly, the Deputy Judge explained, the petitioner should "not be given any perceived advantage of having the Shares valued at a date earlier than the date of the order, as it was his own raising and pursuit of a factual dispute, on which he has ultimately failed, which has caused the delay in him getting the value of the Shares from a dissociation of him from the Company, a position crystallised at the presentation of the Petition". There was accordingly a good reason for the court to depart from the date of presentation of the petition as a matter of fairness.

In *Re Elgindata Ltd* [1991] BCLC 959, Warner J, after concluding that the unfair prejudice he had found had not caused any significant diminution in the value of the petitioners' shares, stated, at 1006:

> "If I am right in the conclusions I have reached as to the extent to which the diminution in value of the petitioners' shares was attributable to conduct on the part of Mr Purslow of which the petitioners are entitled to complain under [the then equivalent of section 994], to fix a date for the value of their shares at or near the time when the company's fortunes were at their peak would be grossly unfair to Mr Purslow."

AN EARLIER DATE OUT OF FAIRNESS FOR THE RESPONDENT

In *Clegg v Edmondson* (1857) 8 De. G.M. & G. 787, 814, Knight Bruce LJ held that:

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> "A man having an adverse claim in equity … should show himself in good time willing to participate in possible loss as well as profit, not play a game in which he alone risks nothing."

The principle in *Clegg v Edmondson*, which arose in the context of a constructive trust claim, was held by the Queensland Court of Appeal to be "equally apposite in the context of a claim that a respondent be compelled to acquire the applicant's shares" in *Rankine v Rankine* (1995) 14 ACLC 116, 122. In that case, Thomas J, after noting the "cardinal principle of equity that the remedy must be fashioned to fit the nature of the case and the particular facts", stated that a "consideration that can favour an early date is that equity leans against permitting a dilatory claimant to gain benefits in an expanding business".

Where a petitioner delays in presenting an unfair prejudice petition in relation to an expanding and successful business, it may be wrong for him to benefit from his delay. It may be said that he should not be permitted to benefit from his inactivity comforted in the knowledge that the company has been thriving over that period, with every prospect of that continuing to be the case. He should not be permitted to profit from the hard work and entrepreneurial gifts of the respondent to the petition after the time when he could, had he wished to have done so, have presented a petition. In such a case, fairness often demands that the court order the petitioner's shares to be valued as at a date substantially before the petition was presented. The petitioner's objection that the company has had "the use of" the capital sum represented by the value of his shares may carry little weight if he has received substantial dividend in the interim, since such dividends would themselves be compensation for such use of capital.

A recent example of the court exercising at the respondents' instigation its power to order that the petitioner's shares be valued as at a date significantly before the petition was presented was *Estera Trust (Jersey) Ltd v Singh* [2018] EWHC 1715 (Ch). In that case, in deciding that the petitioners' delay should not debar them from relief Fancourt J stated that the respondents could be protected from any unfair consequences of delay in other ways, adding, at [633]:

> "One obvious way is by taking an earlier valuation date, reflecting the date at which an order would have been likely to have been made had there been no culpable delay. In my judgment, it would not be just to allow [the Petitioners] to benefit from their calculated delay in bringing proceedings by ordering a valuation of the shares at today's date. Although they did not delay to benefit from an anticipated uplift in value, they did delay tactically, in order to seek to benefit in other ways. The Respondents are fully entitled to say that the Petitioners could and should have brought their case to court much sooner. Had they done so, the starting point for a valuation date would have been much earlier in time."

On the facts of that case, Fancourt J decided that the date as at which the petitioners' shares should be valued should be four years before the date on which he handed down judgment.

QUASI-INTEREST

One matter to bear in mind when considering the issue of date of valuation is that whilst the court does not have power to award interest on the purchase price of the petitioner's shares pursuant to either s 35A of the Senior Courts Act 1981 or its general equitable jurisdiction in respect of any period prior to the making of the purchase order (see *Re Bird Precision Bellows Ltd* [1986] Ch 658, at 677), it does have power under s 996 to make an order for the payment of a sum representing the equivalent of interest. In *Profinance*, at [31], Robert Walker LJ colourfully stated that "a denial of the court's power to award the equivalent of interest would come close to straining at a gnat". Whilst it was "a power which should be exercised with great caution", Robert Walker LJ also stated that whilst he had "described the issue of quasi-interest as logically anterior to the exercise of discretion as to the choice of the valuation date … in practice the two cannot be completely separated, because the circumstances in which it may be fair for the court to take an early valuation date … may also be highly relevant to the petitioner's claim for the equivalent of interest".

Accordingly, in an appropriate case the court may decide that fairness demands that it accede to the respondent's contention that it choose an early valuation date but that in return it should award the petitioner quasi-interest on the purchase price from a date prior to the date on which his shares are purchased, in order to reflect the fact that he did not in fact receive the value of the shares at the valuation date.

In *Estera Trust (Jersey) Ltd v Singh*, however, Fancourt J decided that awarding the petitioners what he described as "notional interest" on the share value was not justified, explaining, at [636]:

> "First, the delay in receipt was the result of the Petitioners' own deliberate delay. Second, interest rates have been at an historic low throughout the period of delay. Third, [the Petitioners] have in fact received significant dividends during that period. It is likely that an allowance in one direction for notional interest and a countervailing allowance for the dividends in fact received would approximately cancel each other out." ■

Further Reading:

- Unfair prejudice petitions: long-range missiles for minority shareholders (2013) 11 JIBFL 694.
- The availability of the unfair prejudice remedy for activist shareholders of public companies (2016) 3 JIBFL 146.
- LexisPSL: Financial Services: Practice Direction – Unfair prejudice petitions.