

# THE VALUATION OF MINORITY SHAREHOLDINGS IN AN OPPRESSION CONTEXT – A CONTEMPORARY REVIEW

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## I INTRODUCTION

Australia's corporations law has always had a strong emphasis on majority rule or 'democracy of the "first past the point" sort, within companies.'<sup>1</sup> The management of the company primarily resides in the board and they should be permitted to operate the company as they see fit (within the confines of their directors' duties). As a consequence, a minority shareholder may have little, if any, 'strategic influence or control over a company's operations.'<sup>2</sup> They may be relatively powerless to influence the development, management and direction of the entity in which they have invested. Shareholders may differ in their views on management issues from those espoused and implemented by the board. Where disagreement occurs, the board and majority shareholders, in seeking to manage the business as they consider proper, may inadvertently or purposefully ostracise, oppress or exclude the views of minority shareholders.

The courts and legislatures have sought to provide protection to shareholders from 'abuse at the hands of the controllers' of a company in these circumstances.<sup>3</sup> One significant remedy available to a minority shareholder in these circumstances is to make an application to the court pursuant to section 233 of the *Corporations Act 2001* (Cth) for the company to compulsorily acquire or buy-out the affected shareholder's shares.

This article will examine the fundamental issues and difficulties encountered by parties and practitioners alike in cases of buy-out remedies for minority oppression. In particular, it will review the way in which the courts determine the value of shares when making a compulsory buy-out order. It will consider whether there has been

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<sup>1</sup> Keith Fletcher, 'CLERP and Minority Shareholder Rights' (2001) 13 *Australian Journal of Corporations Law* 290, 290.

<sup>2</sup> Wayne Lonergan, 'Commercial Law: The Changing Nature of Discount for Minorities' (1999) 37 *Law Society of NSW* 66, 67.

<sup>3</sup> Robert P Austin and Ian M Ramsay, *Ford's Principles of Corporations Law* (LexisNexis Butterworths, 15<sup>th</sup> ed, 2013) 633 [10.010].

any evolution or divergence from the principles set out in precedent cases<sup>4</sup> decided up to the mid-1990s and as extensively reviewed by Sirianos in his article.<sup>5</sup> The review will also touch on developments in the United Kingdom. Particular focus will be given to consideration of the following issues:

- a. What is the purpose of the remedy?
- b. What methodology should the court adopt in arriving at a valuation?
- c. What is the date that the valuation should be made?
- d. Should a discount be applied to a minority interest in the valuation process?

## II DEVELOPMENT OF THE OPPRESSION REMEDY

Until relatively recently the 'primary guarantor of the rights of minority shareholders had been the frequently criticised 'exceptions' to the rule in *Foss v Harbottle*.<sup>6</sup> The rule in *Foss v Harbottle*<sup>7</sup> provided, in summary, that wrongs to the company should be redressed by action by the company in its own name and that courts should not interfere with the internal management of companies acting within their powers. Strict adherence to this rule often denied minority shareholders recourse against unscrupulous directors and majority shareholders. For this reason a number of 'exceptions' were developed by the courts.<sup>8</sup> Although, commentators have said that 'the "exceptions" to the rule in *Foss v Harbottle* are essentially not exceptions at all' but rather situations where the rule simply cannot apply.<sup>9</sup> In addition, a number of practical and legal difficulties regarding the operation of the exceptions have meant that relatively few derivative actions have proceeded. The main difficulties associated with the common law action centred around the effect of ratification of the impugned conduct by the general meeting of shareholders (if effective, the purported

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<sup>4</sup> *Scottish Co-operative Wholesale Society Ltd v Meyer* [1959] AC 324; *Re Bird Precision Bellows Ltd* [1984] 1 Ch 419; *Re Dalkeith Investments Pty Ltd* (1984) 9 ACLR 247; *Re London School of Electronics Ltd* [1985] 3 WLR 474; *Virdi v Abbey Leisure Ltd* [1990] BCLC 342; *Re Bagot Well Pastoral Company Pty Ltd* (1992) 9 ACSR 129; *Coombs v Dynasty Pty Ltd* (1994) 14 ACSR.

<sup>5</sup> Steven Sirianos, 'Problems of Share Valuation under Section 260 of the *Corporations Law*' (1995) 13 *Company and Securities Law Journal* 88.

<sup>6</sup> Fletcher, above n 1, 290.

<sup>7</sup> (1843) 2 Hare 461.

<sup>8</sup> Fletcher, above n 1, 291. For example, where illegal or ultra vires conduct is alleged, where a special majority is required to affect a change, where the personal rights of the plaintiff are affected, where the controllers of the company are perpetuating a fraud on the minority or where the interests of justice required an exception.

<sup>9</sup> K W Wedderburn, 'Shareholders' Rights and the Rule in *Foss v Harbottle*' (1957) *Cambridge Law Journal* 194, 203.

ratification by a majority of shareholders could deny the company as a whole, and hence minority shareholders, any right of action against the directors) and the strict criteria which need to be established before a court may grant relief.<sup>10</sup>

The 'proper plaintiff' rule in *Foss v Harbottle* did not provide adequate means for the enforcement of the duties of directors and officers where the company improperly refused or failed to take action.<sup>11</sup> The potential unfairness of the exceptions was the subject of various reports commissioned by governments,<sup>12</sup> which recommended the introduction of a 'statutory derivative action.'<sup>13</sup> As a consequence, a statutory statement of the law was introduced in section 260 of the Corporations Law and then as part of the *Corporate Law Economic Reform Program Act 1999* (Cth), which subsequently formed the basis of the current section 233 of the *Corporations Act 2001* (Cth).<sup>14</sup> The ambit of section 233 of the *Corporations Act 2001* (Cth) is broader than that previously available to shareholders under the common law, particularly as it applies to current and former members of a company.<sup>15</sup>

Now a shareholder may bring an action against the company in their own right. Such actions may (subject to appropriate grounds existing) include, for example, the:

- enforcement of their personal rights pursuant to the constitution;
- commencement of a statutory derivative action in accordance with Part 2F.1A of the *Corporations Act 2001* (Cth); or
- commencement of winding up proceedings on just and equitable grounds.<sup>16</sup>

However, these remedies may not present an attractive alternative to a shareholder. For example, it would be an 'extreme step'<sup>17</sup> requiring a 'strong case'<sup>18</sup> to wind up a

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<sup>10</sup> Explanatory Memorandum, Corporate Law Economic Reform Program Bill, 19.

<sup>11</sup> Companies and Securities Law Reform Committee, Enforcement of the Duties of Directors and Officers of a Company by means of a Statutory Derivative Action, Report No 12 (1990) [5].

<sup>12</sup> Companies and Securities Law Reform Committee, Enforcement of the Duties of Directors and Officers of a Company by means of a Statutory Derivative Action, Report No 12 (1990); The Corporate Law Economic Reform Proposal, Directors Duties and Corporate Governance, No 3 (1997).

<sup>13</sup> James McConvill, 'Ensuring Balance in Corporate Governance: Parts 2F1 and 2F1.A of the Corporations Law' (2001) 12 *Australian Journal of Corporate Law* 1, 6.

<sup>14</sup> It should be noted that a form of the oppression remedy was first brought into effect pursuant to section 186 of the uniform Companies Acts and subsequently broadened in the State Companies Code.

<sup>15</sup> Further details regarding locus standi requirements in *Corporations Act 2001* (Cth) s 234.

<sup>16</sup> *Corporations Act 2001* (Cth) s 467.

company simply because shareholders were unable to resolve disagreements amongst them or with management.<sup>19</sup> Furthermore, the value that an affected shareholder may be able to extract in the event of a winding up may not reflect the true value of the shares. The alternative would be for the disaffected shareholder to sell their shares. However this may not be commercially satisfactory. It is also likely to be impractical in a small proprietary company on account of the lack of a market for such shares. Furthermore, the mere inability to sell those shares, in the absence of any other unlawful behaviour (for example misusing provisions in a company's constitution to frustrate a sale process),<sup>20</sup> does not represent any commercial unfairness.<sup>21</sup> Therefore, absent any favourable or workable exit mechanism in their shareholders' agreement or the company's constitution, minority shareholders face great difficulties in extracting themselves from this unfavourable, if not untenable, situation.

### III BACKGROUND

It may then be necessary to instigate a more aggressive and necessarily litigious approach to reach an acceptable outcome. Relevantly, Young J commented in *Mike Gaffikin Marine Pty Ltd v Princes Street Marina Pty Ltd* that '[m]odern lawyers and accountants...are skilled in baiting the majority until the majority step over the line and a suit can be commenced which will give relief.'<sup>22</sup> A potential exit mechanism for the minority shareholder is to seek to avail themselves of the minority oppression remedies set out in the *Corporations Act 2001* (Cth)<sup>23</sup> or the *Companies Act 2006* (UK).<sup>24</sup> This potentiality is borne out in practice. The oppression remedy has played a valuable role in relation to resolving disputes between shareholders in small or closely-held companies.<sup>25</sup> Empirical evidence has found that almost 75% of

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<sup>17</sup> *Cumberland Holdings Limited v Soul H Pattinson & Co Limited* (1977) 13 ALR 561; 2 ACLR 307 at 312.

<sup>18</sup> *Australian Securities and Investment Commission v ABC Fund Managers & Ors* (2001) 39 ACSR 443, 470.

<sup>19</sup> *National Hospitality Concepts Pty Limited v National Marketing Concepts Inc* (No 2) (1994) 13 ACSR 368.

<sup>20</sup> *Mincom Pty Ltd v Murphy* (1982) 7 ACLR 370.

<sup>21</sup> *Lucy v Lomas* [2002] NSWSC 448.

<sup>22</sup> (1995) 17 ACSR 495, 505.

<sup>23</sup> *Corporations Act 2001* (Cth) pt 2F.1.

<sup>24</sup> *Companies Act 2006* (UK) ss 994-996.

<sup>25</sup> Ian M Ramsay, 'An Empirical Study of the Use of the Oppression Remedy' (1999) 27 *Australian Business Law Review* 23.

oppression cases involved a private company and in almost 45% of those cases, the number of shareholders in the company concerned was less than five.<sup>26</sup>

Whilst identifying the most potent remedy may be relatively straight forward, extracting appropriate value, or being able to advise a potential litigant, as to what value their shares may be valued at, is a more complicated task.

Despite extensive caselaw on this remedy, few if any clear principles have consistently been enunciated in this regard. Rather, the courts have worked within broad discretions and loosely expressed 'rules and principles' which not do give satisfactory clarity as to how to value shares in this context. Indeed in some instances the 'rules' espoused by the courts are subject to so many exceptions that in reality, the exceptions have become the 'rule'. Lawyers prefer clear statements of law and as noted by Young J, it is in the public interest that the courts follow a uniform approach.<sup>27</sup> The absence of clear guidance makes this area of law difficult for practitioners to offer advice with any degree of certainty. Arguably, this is consequential upon the many and varied circumstances in which minority protection is sought and the valuation process itself (refer to the discussion below). The corollary of this is that it is not possible, or prudent, for the courts and legislatures to attempt to enumerate the relevant approaches and therefore restrict a court's discretion.

### IV WHAT IS OPPRESSION?

Relief is not available under section 232 of the *Corporations Act 2001* (Cth) merely because a shareholder is dissatisfied with the running of the company or they are dissatisfied with their position or the fact that they cannot control the management of the company. Something more is required. Relevantly Spigelman CJ observed in *Fexuto Pty Ltd v Bosnjak Holdings Pty Ltd* that 'irreconcilable differences may establish a basis for winding up, they do not of themselves constitute oppression or unfair prejudice.'<sup>28</sup> The courts have held that oppression connotes a lack of probity and fair dealing<sup>29</sup> (although this is not a necessary condition),<sup>30</sup> is something which is burdensome, harsh or wrongful,<sup>31</sup> or is inequitable or unjust,<sup>32</sup> or exhibits commercial

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<sup>26</sup> Ibid 23-9.

<sup>27</sup> *Fedorovitch v St Aubins Pty Ltd* (1999) 17 ACLC 1558, 1559.

<sup>28</sup> (2001) 37 ACSR 672 [89].

<sup>29</sup> *Scottish Co-op Wholesale Society Ltd v Meyer* [1959] AC 324, 364.

<sup>30</sup> *Campbell v Backoffice Investments Pty Ltd* (2009) 238 CLR 304, 360.

<sup>31</sup> *Scottish Co-op Wholesale Society Ltd v Meyer* [1959] AC 324, 342.

<sup>32</sup> *ASC v Multiple Sclerosis Society of Tasmania* (1993) 10 ACSR 489.

unfairness.<sup>33</sup> The conduct must relate to the 'affairs of the company', which has been determined to be of considerable breadth.<sup>34</sup> In determining whether allegations of oppression have been made out, the court must examine the conduct, not in isolation, but in the context in which it takes place<sup>35</sup> and where the relevant conduct involves directors of a company are acting honestly in the interests of the company.<sup>36</sup> The test requires the weighing of the particular member's interest against that of the company as a whole.<sup>37</sup>

Examples of the types of behaviours that trigger minority protection remedies include a majority shareholder:

- running the company in their own interests and ignoring the interests of minority shareholders;<sup>38</sup>
- improperly issuing shares to themselves to outvote other shareholders;<sup>39</sup>
- excluding a minority shareholder from being involved in the management decisions of the company;<sup>40</sup>
- redirecting business opportunities from the company to themselves;<sup>41</sup> or
- paying themselves excessive salaries at the expense of dividends to the shareholders.<sup>42</sup>

These actions may impact on the value of a minority shareholder's investment and frequently lead to disputes between the parties.

## V MINORITY PROTECTIONS

The Australian and English legislatures have enacted protections in favour of minority shareholders to address these issues. These remedies provide some outer limits to what may otherwise be the unfettered power of the majority (subject to the application of any of the exceptions to the rule in *Foss v Harbottle*). In Australia, the

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<sup>33</sup> *Morgan v 45 Flers Avenue Pty Ltd* (1986) 10 ACLR 692, 704.

<sup>34</sup> *Corporations Act 2001* (Cth) s 53.

<sup>35</sup> *Reid v Bagot Well Pastoral Co Pty Ltd* (1993) 12 ACSR 197, 212; *Re George Raymond Pty Ltd* (2000) 18 ACLC 85.

<sup>36</sup> *Wayde v New South Wales Rugby League* (1985) 180 CLR 459.

<sup>37</sup> *Ibid.*

<sup>38</sup> See, eg, *Re Spargos Mining NL* (1990) 3 ACSR.

<sup>39</sup> See, eg, *Hannes v MJH Pty Ltd* (1992) 7 ACSR 8.

<sup>40</sup> See, eg, *Fexuto Pty Ltd v Bosnjak Holdings Pty Ltd* (1998) 28 ACSR 688.

<sup>41</sup> See, eg, *Scottish Co-operative Wholesale Society Ltd v Meyer* [1959] AC 324.

<sup>42</sup> See, eg, *Sanford v Sanford Courier Service* (1986) 10 ACLC 549.

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relevant legislative protections are set out in Part 2F.1 of the *Corporations Act 2001* (Cth) which gives the court jurisdiction to give relief to a shareholder if it is of the opinion that:

- a) 'the conduct of the company's affairs;
- b) an actual or proposed act or omission by or on behalf of a company; or
- c) a resolution, or proposed resolution, of members or a class of members of a company,

is either:

- d) contrary to the interests of the members as whole; or
- e) oppressive to, unfairly prejudicial to, or unfairly discriminatory against, a member of members whether in that capacity or in any other capacity.'<sup>43</sup>

In England, section 994 of the *Companies Act 2006* provides that a member of a company may apply to the court by petition for an order:

- a) that the company's affairs are being or have been conducted in a manner that is unfairly prejudicial to the interests of members generally or of some part of its members; or
- b) that an actual or proposed act or omission of the company (including an act or omission on its behalf) is or would be so prejudicial.

The exact scope of the remedies may be slightly different between the jurisdictions; however, this is not relevant or material for the purposes of this article.<sup>44</sup> In this article, these actions will be collectively referred to as oppressive conduct.

## VI REMEDIES AVAILABLE

Once oppressive conduct has been established, amongst other remedies and subject always to the court's general discretion to grant whatever relief it deems appropriate,<sup>45</sup> an order may be sought for the petitioner's shares to be purchased by:

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<sup>43</sup> *Corporations Act 2001* (Cth) s 232.

<sup>44</sup> For example, Australian caselaw has found that the words 'oppressive, unfairly prejudicial or unfairly discriminatory' provide a wider basis on which a plaintiff may seek relief than the single term 'oppressive' did under the earlier Australian legislation (see *Morgan v 45 Flers Avenue Pty Ltd* (1986) 10 ACLR 692 (Young J)). Applying this argument to the *Companies Act 2006* (UK), it is likely that the scope of the English remedy is potentially smaller than the protection afforded under the *Corporations Act 2001* (Cth) given that the *Companies Act 2006* (UK) only refers to acts that are unfairly prejudicial.

- the company;<sup>46</sup> or
- a member – generally the majority shareholders.<sup>47</sup>

Out of the ‘smorgasbord of remedies’<sup>48</sup> available, a compulsory buy-out is the most common<sup>49</sup> and ‘usual’<sup>50</sup> order sought in oppression cases so as to achieve a ‘clean break between the parties.’<sup>51</sup> However the ‘most difficult’<sup>52</sup> and ‘contentious’<sup>53</sup> questions for the court and the parties to address at this juncture are:

- a) What is the value to be ascribed to the shares?
- b) How is this value to be determined?

Unfortunately both legislatures have not provided guidance on these issues and are ‘silent about the terms on which such a sale may be ordered.’<sup>54</sup> On one view this is unsatisfactory given their capacity to provide certainty for parties by enumerating the relevant basis for the valuation. However, given the ‘endless variety of circumstances in which oppression may occur’<sup>55</sup> and the numerous factors that may interpose on a valuation, it is perhaps impossible and imprudent for legislation to deal with these issues.

Whilst Mason J noted that ‘[t]here is always the risk that in examining methods of valuation that attention is diverted from the object of the exercise, namely the

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<sup>45</sup> Under the *Corporations Act 2001* (Cth) ten species of orders are identified – ranging from an order for winding-up to an order restraining a person from engaging in specified conduct or from doing a specified act, or requiring a person to do a specified act. The *Companies Act 2006* (UK) provides remedies including the obligation of the offending shareholder or the company to refrain from doing or continuing an act complained of, require the company not to make any, or any specified, alterations in its articles without the leave of the court.

<sup>46</sup> *Corporations Act 2001* (Cth) s 233(1)(e); *Companies Act 2006* (UK) s 996(2)(e).

<sup>47</sup> *Corporations Act 2001* (Cth) s 233(1)(d); *Companies Act 2006* (UK) s 996(2)(e). Noting that the court may also order that a minority shareholder petitioner purchase the shares in the company of the respondent majority – see, eg, *Re a Company (No 00789 of 1987)*, *ex parte Shooter* [1990] BCLC 1; *Re Brenfield Squash Racquets Club Ltd* [1996] 2 BCLC 184.

<sup>48</sup> *Fexuto Pty Ltd v Bosnjak Holdings Pty Ltd* [1998] 28 ACSR 688, 742 (Young J).

<sup>49</sup> Sirianos, above n 5, 91.

<sup>50</sup> *Grace v Biagioli* [2006] 2 BCLC 70 [75].

<sup>51</sup> *In re Clearsprings Management Ltd* [2003] EHC 2517 (Ch) [25].

<sup>52</sup> Robin Hollington, *Shareholders’ Rights* (Sweet & Maxwell, 5<sup>th</sup> ed, 2007) 311.

<sup>53</sup> Sirianos, above n 5, 90.

<sup>54</sup> *Campbell v Backoffice Investments Pty Ltd* (2009) HCA 25 [176].

<sup>55</sup> Sirianos, above n 5, 89.



ascertainment of the real value of the shares',<sup>56</sup> it is however appropriate to understand (even at a rudimentary level) the types of valuation methodologies available. In this context it is appropriate to review the commercial valuation process. This is relevant to determine whether the courts' approach in oppression contexts alters normal valuation procedures and if so, if there are appropriate grounds to do so.

## VII VALUATION IN A NON-OPPRESSION CONTEXT

It has been noted that the valuation of shares, is of itself, 'an art not a science',<sup>57</sup> dependent upon 'a certain amount of guesswork'<sup>58</sup> and without 'any definitive methodology that can be used on all occasions.'<sup>59</sup> A valuation involves 'a valuer's personal judgement and opinion rather than the strict application of accounting principles or arithmetic rules.'<sup>60</sup> Similarly as Mason J said in the *Federal Commissioner of Taxation v St Helens Farm (ACT) Pty Ltd* '[e]ssentially valuations are estimations involving findings of fact and discretionary judgment made on the evidence given in the individual case and by reference to the circumstances of that case.'<sup>61</sup> This is further complicated where the shares are equities in small, tightly held companies or 'quasi partnerships' which do not have access to a highly competitive, negotiable market and often lack sophisticated financial reporting capabilities on which valuation is itself dependent. Given this it is quite reasonable and cogent to understand why the legislatures have seen fit to avoid stipulating the process by which a valuation must be undertaken.

Standard valuation practice is to determine the value of a share, as with any asset, by calculating the future benefits to be derived from ownership of that share. This entails a calculation of the future cash flows expected to be derived from ownership of the share. This figure is discounted to reflect the risk associated with earning those cash flows and the time frame over which they are expected to be earned.<sup>62</sup> Different

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<sup>56</sup> *In the Marriage of Mallett* (1984) 52 ALR 193, cited in Heather Kind, 'Valuing Minority Interests In Family Entities' (1996) 11(1) *Australian Family Lawyer* 22, 22.

<sup>57</sup> *Joiner v George* [2003] BCC 298. See also *Gold Coast Selection Trust Limited v Humphrey* [1948] AC 459, cited in Lonergan, above n 2, 12.

<sup>58</sup> *Myer v Commissioner of Taxes* [1937] VLR 106, cited in Lonergan, above n 2, 12.

<sup>59</sup> Wayne Lonergan, *The Valuation of Businesses, Shares and Other Equity* (Allen & Unwin, 4<sup>th</sup> ed, 2003) 3.

<sup>60</sup> Sirianos, above n 5, 90.

<sup>61</sup> (1981) 146 CLR 336, 383 cited in *Garraway v Territory Realty Pty Ltd* [2010] FCAFC 9.

<sup>62</sup> See A M and A V Adamson, *The Valuation of Company Shares and Businesses* (Law Book Company Limited, 7<sup>th</sup> ed, 1986).

methodologies may be employed to undertake this task. Each is likely to reach a different valuation on the same information and 'each of the methods will not be equally suitable or appropriate in all circumstances.'<sup>63</sup> For the purposes of this article a brief overview will only be provided of:

- capitalisation of future maintainable earnings;
- capitalisation of future maintainable profits; and
- discounted cash flow.

There are, of course, many more examples of methodologies that may be used.<sup>64</sup>

### ***A Capitalisation of Future Maintainable Earnings***

Capitalisation of future maintainable earnings is the most generally accepted method of valuing an actively trading business.<sup>65</sup> Lonergan states that 'in the absence of reliable long-term cash flow forecasts it is normal valuation practice to assess the fair market value of a profitable company or business on the basis of the capitalisation of future maintainable earnings.'<sup>66</sup> The value of the business is represented by its core underlying earnings capitalised by an earnings multiple. This multiplier should reflect the risk and future potential of those earnings. The determination of this multiple is at the discretion and professional judgment of the valuer.

### ***B Discounted Cash Flow***

The discounted cash flow ('DCF') method has been noted as being particularly useful when valuing a business as a going concern.<sup>67</sup> This is because the method assumes that the business being valued will continue to trade at a profit and the value of the company's operating assets are comprised within the value of the profits, that it is assumed the company will continue to generate. However, as Hargrave J noted that this may not always be the case and it will be necessary in some circumstances for the expert to also employ a secondary method such as the orderly realisation of assets method as a safeguard to confirm the value of the company.<sup>68</sup>

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<sup>63</sup> Sirianos, above n 5, 97.

<sup>64</sup> For example, capitalisation of maintainable dividends. As a majority shareholder may determine dividend performance this method is not generally suitable in an oppression context.

<sup>65</sup> Kind, above n 56, 25.

<sup>66</sup> Lonergan, *The Valuation of Businesses, Shares and Other Equity*, above n 59, 26.

<sup>67</sup> *Candoora No 19 Pty Ltd v Freixenet Australasia Pty Ltd* [2008] VSC 367 (Hargrave J).

<sup>68</sup> *Candoora No 19 Pty Ltd v Freixenet Australasia Pty Ltd* [2008] VSC 367 (Hargrave J). See also *Bromley v Elkington* (2002) 43 ACSR 584.

The other risk inherent in the DCF method arises from the number of controversial assumptions that are made in this method. Talbot J extrapolated this point in *Collex Pty Ltd v Roads and Traffic Authority of NSW* that '[a]lthough the courts have clearly experienced difficulty from time to time in accepting the DCF method due to the unreliability of the assumptions made for the purpose of the analysis, it is nonetheless a method which can be accepted where the special facts and circumstances...make it appropriate to do so.'<sup>69</sup>

### ***C Capitalisation of Future Maintainable Profits (FMP)***

For projects with an almost infinite life, it is difficult to forecast future cash flows beyond several years and it is also difficult to obtain comparable information from other entities. Thus the usual approach in valuing an ongoing entity is to estimate a figure for FMP and to multiply this figure at an appropriate price-earnings ratio (PER).<sup>70</sup> It is also well suited to valuing controlling interests.<sup>71</sup> The risks associated with the entity to be acquired are taken into account in setting the PER. Capitalisation of FMP is not suitable where there is a history of losses, rapidly declining profits, the industry has poor prospects, or the company is trading but suffers from severe liquidity problems.<sup>72</sup>

### ***D Discretionary Factors in Valuations***

A minority interest carries with it a whole range of rights and obligations set out in the constitution and the terms of the shares themselves. It also suffers from restrictions and disadvantages. Any valuation must assess the present value of all benefits and future possibilities attaching to the interest, having regard to those disadvantages. In summary, Kind notes that there are two major factors which require a minority interest to be discounted in the valuation process:

- lack of control; and
- lack of negotiability.<sup>73</sup>

The particular factors, which will influence the choice of the discount to be applied include, amongst others:

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<sup>69</sup> (2006) 149 LGERA 234 [82].

<sup>70</sup> Lonergan, *The Valuation of Businesses, Shares and Other Equity*, above n 59, 29.

<sup>71</sup> Ibid 30.

<sup>72</sup> Ibid.

<sup>73</sup> Kind, above n 56, 23. See also *Lynall Martin v FCT* [2009] NSWSC (16 November 1983) (Hunt J), cited in Sirianos, above n 5, 91.

- rights attaching to the shares detailed in the constitution and any shareholders' agreement;
- historical and future dividend policy;
- the existence of a controller;
- the size of the minority interest relative to other shareholdings in the company; and
- the relationships between the minority interest holders and any controllers.<sup>74</sup>

Discounts for minority interests and the related non-negotiability are well-established 'facts of commercial life'<sup>75</sup> and are the 'inevitable financial reflection of the relatively disadvantageous position of the minority'<sup>76</sup> and only in special circumstances will they not be applied.<sup>77</sup>

## VIII JUDICIAL PRACTICE IN OTHER CIRCUMSTANCES

The courts are required to value minority shareholdings in other contexts such as tax and duty assessments and compulsory acquisition in controlled transactions. It is relevant to consider the approach of the courts to valuing minority holdings in these contexts.<sup>78</sup> The basic principle was stipulated in *Spencer v The Commonwealth*<sup>79</sup> where it was held that the court should determine 'what would a man desiring to buy the land [or asset] have to pay for it on that day to a vendor willing to sell it for a fair price but not desirous to sell?' An alternative formulation was expressed by Gibbs J in *Gregory v Federal Commissioner of Taxation* in that the 'test may be expressed in its most practical form by saying that the vendor is entitled to that which a prudent purchaser would have been willing to give for the shares sooner rather than fail to obtain them.'<sup>80</sup> This test is often paraphrased as the price that a willing but not anxious seller and a willing but not anxious buyer would agree on.

ASIC Regulatory Guide 111 'Content of expert reports' ('RG 111') provides that an expert preparing a valuation report in a controlled transaction context<sup>81</sup> should, when

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<sup>74</sup> Kind, above n 56, 24.

<sup>75</sup> Lonergan, above n 2, 67.

<sup>76</sup> Ibid 72.

<sup>77</sup> See, eg, *O'Neill v Phillips* [1999] 2 BCLC 1.

<sup>78</sup> Lonergan, above n 2, 68.

<sup>79</sup> (1907) 5 CLR 418, 432 (Griffith J).

<sup>80</sup> (1971) 123 CLR 547, 564-5.

<sup>81</sup> For example, takeover bid under Chapter 6 or a scheme of arrangement under Part 5.1 of the *Corporations Act 2001* (Cth).

possible, use more than one valuation method. The expert should use their skill and judgment to select the most appropriate methodology or methodologies.<sup>82</sup> The expert must have a reasonable (or tenable) basis for choosing its valuation methodology.<sup>83</sup> The valuation should be based on reasonable assumptions and disclose all material assumptions.<sup>84</sup> However, it goes on to state that:

[ASIC] will not prescribe the valuation methodologies that an expert should use in preparing its report since an expert should exercise its own skill and judgement to choose methodologies that are appropriate in the circumstances of the entity...being valued.<sup>85</sup>

The key aspects to note from this review are that in a normal valuation process for a minority shareholding:

- a) the methodology selected must be tenable and selected to best reflect the factual scenario;
- b) a discount for the minority interest is standard; and
- c) the date for the valuation is the date of acquisition.

Lonergan observes that it is becoming more common for courts to ignore or alter traditional commercial, economic and valuation principles and, in some cases, for different rules to apply.<sup>86</sup> The key question is that, if this is the case, what are the justifications for this?

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<sup>82</sup> It is generally accepted for an expert to consider using the following methodologies in a controlled transaction:

- a) the discounted cash flow method and the estimated realisable value of any surplus assets;
- b) the application of earnings multiples (appropriate to the business or industry in which the entity operates) to the estimated future maintainable earnings or cash flows of the entity, added to the estimated realisable value of any surplus assets;
- c) the amount that would be available for distribution to security holders on an orderly realisation of assets;
- d) the quoted price for listed securities, when there is a liquid and active market and allowing for the fact that the quoted price may not reflect their value, should 100% of the securities be available for sale;
- e) and any recent genuine offers received by the target for any business units or assets as a basis for valuation of those business units or assets.

<sup>83</sup> *Re Matine* (1998) 28 ACSR 268, 290-291.

<sup>84</sup> ASIC Regulatory Guide 111 Content of expert reports 2011 (Cth) regs 111.59, 111.60.

<sup>85</sup> *Ibid* regs 111.59, 111.60.

<sup>86</sup> Lonergan, above n 2, 67.

## IX GENERAL PRINCIPLES IN AN OPPRESSION CONTEXT – A BROAD DISCRETION

The fundamental justification is that the court is vested with a broad discretion in determining this issue.<sup>87</sup> The court should not be overly limited or restricted. French CJ in *Campbell v Backoffice Investments Pty Ltd*, the most recent High Court of Australia case on oppression, stated that the language and history of the remedy indicates that it is to be read broadly and any imposition of limitations on the remedy by the courts 'is to be approached with caution.'<sup>88</sup> Importantly, the remedy 'should not be hedged about by implied limitations.'<sup>89</sup> The only restriction is that the court should be limited by the requirement that it be informed by justice and fairness to the particular facts.<sup>90</sup> This is similar to Oliver LJ's statement in *Re Bird Precision* 'that the whole framework...is to confer on the court a very wide discretion to do what is considered fair and equitable in all the circumstances of the case'.<sup>91</sup> Furthermore the discretion should not be restricted 'in the manner in which the price is to be assessed.'<sup>92</sup>

Leaving aside the obvious caveat that the effect of the oppressive conduct on the share value is to be disregarded,<sup>93</sup> this broad discretion is the only consistent principle of interpretation provided by the courts in Australia and the United Kingdom. The question is what is, or should be the touchstone of this broad discretion or more generally what is the nature of the remedy to be granted? This discretion also informs the court's approach to other more specific matters.

### ***A What is the Purpose of the Valuation Process in an Oppression Context?***

Australian legal commentary summarises the purpose of the remedy as, to determine a value of the subject shares that is 'fair on the facts of the particular case.'<sup>94</sup> Joffe

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<sup>87</sup> *Re London School of Electronics Ltd* [1985] 3 WLR 474; *Coombs v Dynasty Pty Ltd* (1994) 14 ACSR 60.

<sup>88</sup> [2009] HCA 25 [72].

<sup>89</sup> *Campbell v Backoffice Investments Ltd* [2009] HCA 25 [178].

<sup>90</sup> *Foody v Horewood* (2007) 62 ACSR 576.

<sup>91</sup> [2002] NSWSC 10, [14] (Davies AJ) citing, with approval, *Re Bird Precision Bellows Ltd* [1986] 1 Ch 658 [1986] 1 Ch 658.

<sup>92</sup> *Ibid.*

<sup>93</sup> *Re Associated Tools Industries, Re Bread Ltd; the Queensland Co-operative Milling Association v Hutchinson* [1977] Qd R 44; *Sanford v Sanford Courier Service Pty Ltd & Ors* (1986) 10 ACLR 549; *Re Dalkeith Investments Pty Ltd* (1984) 9 ACLR 247; *Scottish Co-operative Wholesale Society Ltd v Meyer* [1959] AC 324.

<sup>94</sup> Robert P Austin and Ian M Ramsay, *Ford's Corporation Law* (LexisNexis Butterworths, 14<sup>th</sup> ed, 2009) [11, 493].

summarises the English position as similarly requiring the valuation to 'be fair.'<sup>95</sup> Fairness requires the court to disregard the impact of the majority's actions on the share price,<sup>96</sup> the minority's actions,<sup>97</sup> select a date for the valuation that does justice between the parties<sup>98</sup> (although in practice tends to favour the minority) and (generally) not discount the minority shareholder's stake in contrast to normal commercial practice. These requirements imply that the court's obligations are to ensure that the minority shareholder receives an amount for their shares that does not unduly reward the majority for their oppressive conduct.<sup>99</sup> As Sirianos notes, 'to permit the majority to compulsorily acquire the minority interest at a price which reflects the effect of the oppressive conduct...would only provide the majority with a perverse incentive to oppress'<sup>100</sup> However, as discussed, these obligations do not align with commercial practice or understanding.

### **B Fair, Fair Value, or Fair Price in the Circumstances?**

In the prescient English case of *In re Bird Precision Bellows Ltd* it was held that it is 'axiomatic that a price fixed by the court must be fair.'<sup>101</sup> Similarly, in *Scottish Co-operative Society v Meyer*, Lord Sorn noted that the determination should be of a 'fair price'.<sup>102</sup> These were conjugated in the formulation in *Diligenti v RWMD Operations Kelowna Ltd* (No 2) that the valuation should determine a 'fair value or price'.<sup>103</sup> It is important to note that 'fair value' or 'fair price' does not equal 'market value' or 'fair market value' in a valuation sense.<sup>104</sup> A similar construction was given in the Australian case of *Sanford v Sanford Courier Service Pty Ltd*.<sup>105</sup> Common to each was the qualification that the valuation was 'to be arrived at...disregarding the effect of the oppressive conduct which has occurred.'<sup>106</sup> This is non-contentious. This approach was echoed by Young J in *E S Gordon Pty Ltd v Idemeneo (No 123) Pty Ltd* where a further qualification was noted that in determining value, if there was any

<sup>95</sup> Victor Joffe, D Drake, G Richardson, D Lightman, T Collingwood, *Minority Shareholders Law, Practice and Procedure* (Oxford University Press, 4<sup>th</sup> ed, 2011) 334.

<sup>96</sup> See, eg, *Re Dalkeith Investments Pty Ltd* (1984) 9 ACLR 247.

<sup>97</sup> See, eg, *Short v Crawley (no 30)* [2007] NSWSC 1322 (White J).

<sup>98</sup> See, eg, *Mopeke Pty Ltd v Airport Fine Foods Pty Ltd* [2007] 61 ACSR 395.

<sup>99</sup> *Smith Martis Cork & Rajan PTY v Benjamin Corporation Pty Ltd* (2004) 207 ALR 136 [81].

<sup>100</sup> Sirianos, above n 5, 103.

<sup>101</sup> Above n 4, 429.

<sup>102</sup> Above n 98, 369.

<sup>103</sup> (1977) 4 BCLR 134, 166.

<sup>104</sup> *Ibid* 166. See also *Reid v Bagot Well Pastoral Co Pty Ltd* (1992) 9 ACSR 129; *Joint v Stephens* (2008) 26 ACLC 1, 467.

<sup>105</sup> (1986) 10 ACLC 549.

<sup>106</sup> *Ibid* 562.

uncertainty then any erring should be 'on the side of the oppressed.'<sup>107</sup> Further support for the 'fair in all the circumstances' approach is to be garnered by von Doussa J's judgment in *Coombs v Dynasty Pty Ltd*<sup>108</sup> and the judgments in *Re Dalkeith Investments Pty Ltd*,<sup>109</sup> *Re Bagot Well Pastoral Co Pty Ltd*,<sup>110</sup> *Shannon v Reid*<sup>111</sup> and *Re Quest Exploration Pty Ltd*<sup>112</sup> and more recently in *Short v Crawley (No 30)*.<sup>113</sup> The approach of the High Court of Australia in *Gambotto v WCP*<sup>114</sup> is also instructive (even if not directly on point).

In *Profinance Trust*, the Court noted that 'the starting point' should be the general proposition stated by Nourse J in *In re London School of Electronics Ltd*<sup>115</sup> and 'that the overriding requirement is that the valuation be fair on the facts of the particular case.'<sup>116</sup> The recent Australian cases of *Shirim Pty Ltd v Fesena Pty Ltd*<sup>117</sup> and *Smith Martis Cork & Rajan Pty Ltd v Benjamin Corp Pty Ltd* reinforced the view that the court's 'task is to fix a price that represents a fair value in all of the circumstances'<sup>118</sup> (noting the further comments below regarding the findings in *Shirim*).

The words 'fair value' have a particular meaning in valuation parlance and normal commercial understanding that differs from those connotations that may flow from 'fair price' or fairness in the cases above. For example commercial valuers and Australian Accounting Standards define 'fair value' to be 'the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction[...]'.<sup>119</sup> In contrast, in these judgments it may be interpreted as describing a price that includes some compensatory factor and/or some amount that would otherwise be discounted on account of it being a minority shareholding. These may appear to be small discrepancies in nomenclature but it

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<sup>107</sup> (1994) 15 ACSR 536, 540.

<sup>108</sup> (1994) 14 ACSR 60 (von Doussa J) citing various English and Australian precedents: *Re Bird Precision Bellows Ltd* [1984] 2 WLR 869, 876; *Re London School of Electronics Ltd* [1985] 3 WLR 474, 484; *Sanford v Sanford Courier Service Pty Ltd* (1986) 10 ACLR 549, 562.

<sup>109</sup> [1984] 9 ACLR 247, 255.

<sup>110</sup> (1992) 9 ACSR 129.

<sup>111</sup> (1992) 9 ACSR 129, 146.

<sup>112</sup> (1992) 6 ACSR 659.

<sup>113</sup> [2007] NSWSC 1322.

<sup>114</sup> (1995) 13 ACLC 342, 349.

<sup>115</sup> [1986] Ch 211, 224.

<sup>116</sup> [2002] 1 WLR 1024, 1041-1642.

<sup>117</sup> [2002] NSWSC 10.

<sup>118</sup> (2004) 207 ALR 136.

<sup>119</sup> Wayne Lonergan, 'Fair Value, Market Value or Fair Market Value?' 38 (2000) No. 5 *Law Society of New South Wales Journal* 46, 47.



may have significant impacts on valuation. What can be determined from the case law is that the terms are used imprecisely and potentially without due understanding of the different commercial understandings.

However, some cases consider that the remedy 'is in the nature of compensation for a wrong rather than an adjustment of equally meritorious parties.'<sup>120</sup>

### C Compensation

In his judgment in *Scottish Co-operative Wholesale Society Ltd v Meyer*, Lord Denning held that a purchase order 'gives to the oppressed shareholders what is, in effect, money compensation for the injury done to them.'<sup>121</sup> This was followed in *Re a Company No 002612 of 1984*<sup>122</sup> and in *Rankine v Rankine* where it was noted that 'by ordering the compulsory purchase of the applicant's shares...the court is in effect awarding compensation for the respondent's breach of duty.'<sup>123</sup> The compensatory nature of the remedy was regarded by the Court, in *Smith Martis Cork & Rajan Pty Ltd and Others v Benjamin Corporation Pty Ltd*, as being 'established ever since the decision of the House of Lords in *Scottish Co-operative Wholesale Society Ltd v Meyer*.'<sup>124</sup> However it is only acknowledged intermittently in many subsequent judgments, which whilst citing *Scottish Co-operative Wholesale Society Ltd*, have only focussed on the fairness requirement but have not identified (at least expressly) the touchstone of compensation. The compensatory aspect is not been consistently cited by subsequent courts until *Shirim Pty Ltd v Fesena Pty Ltd* where it was held that '[i]n the application of this principle, the Court treats the order for the purchase of the shares as a means by which the minority shareholder is compensated for the oppression which has occurred.'<sup>125</sup> *United Rural Enterprises Pty Ltd v Lopmand Pty Ltd and Ors*<sup>126</sup> and *Vadori v AAV Plumbing*<sup>127</sup> are further examples of the courts continued recent acknowledgement of the compensatory aspect.

Whilst it is contended that both formulations may reach similar determinations, the compensatory formulation better encapsulates the purpose of the remedy and aligns with commercial understanding in a more appropriate manner. This is because, as discussed above, normal commercial practice would, in determining a fair value or

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<sup>120</sup> Austin and Ramsay, above n 3, [11, 490].

<sup>121</sup> [1958] 3 All ER 66.

<sup>122</sup> (1986) 2 BCLC 99, 495.

<sup>123</sup> (1995) 124 FLR 340.

<sup>124</sup> (2004) 207 ALR 136, [71]-[72].

<sup>125</sup> [2002] NSWSC 10 [14] (Davies J).

<sup>126</sup> (2003) 47 ACSR 514 (Campbell J).

<sup>127</sup> [2010] NSWSC 274 (Ward J).

fair price, discount the stake being acquired to reflect the associated rights and obligations and value the company as is – that is, without discount and valuing the shares as at the date of valuation. The ‘overvaluing’ of the shares vis-à-vis their true market value (or fair value in accounting terms) must only be characterised as being in the order of compensation for the wrongs committed against the minority shareholder by the majority or the company. It is contended that those judgments which consider that the purpose is to compensate the minority for the prejudice committed against them, should be preferred to those that refer solely to a determination of ‘fair price’ and ‘fair value’ because, on their own, they are used misleadingly and incorrectly given market practice.

### ***D Fair, Compensatory and Judicial Discretion***

In *Smith Martis Cork & Rajan Pty Ltd and Others v Benjamin Corporation Pty Ltd*<sup>128</sup> the Full Court of the Federal Court of Australia acknowledged three aspects to the remedy. Firstly, that the court's task ‘is to fix a price that represents a fair value in all the circumstances.’<sup>129</sup> Secondly, citing Davies J in *Shirim Pty Ltd v Fesena Pty Ltd*<sup>130</sup> the purpose of an order that the oppressor purchase the shares at a fair price is to compensate the oppressed shareholder for the oppression that has taken place. Thirdly, ‘the only restriction on the way in which the price may be calculated is that it must be a proper exercise of judicial discretion.’<sup>131</sup>

It is submitted that this is the most apt description of the court's purpose in the oppression context. It expressly acknowledges the compensatory nature of the remedy thereby removing the inconsistencies that the ‘fair price’ or ‘fair value’ formulations have with standard commercial practice, tempered by the requirement that the valuation be fair and within the boundaries of judicial discretion.

## **X HOW TO VALUE THE COMPANY**

The caselaw has delineated that this should be undertaken as a two-stage process:

- a determination of the appropriate methodology to value the subject company as a whole; and
- applying the agreed methodology to value the subject shares themselves.<sup>132</sup>

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<sup>128</sup> (2004) 207 ALR 136.

<sup>129</sup> Ibid, citing *Coombs v Dynasty Pty Ltd* (1994) 14 ACSR 60, 102.

<sup>130</sup> [2002] NSWSC 10 (Davies J).

<sup>131</sup> Ibid [75], citing *United Rural Enterprises Pty Ltd v Lopmand Pty Ltd* (2003) 47 ACSR 514 [36] (Campbell J).

<sup>132</sup> *Diligenti v RWMD Operations Kelowna Ltd (No 2)* (1977) 4 BCLR 134, 166.

Judgments do not always address methodology issues in detail. As a broad statement, earlier cases rarely dealt with the detail of how the company was valued. Rather, this was left to the experts and the court considered the value and determined and amended it according to the discretionary issues identified at trial. Some recent cases have considered the methodology to be used and the assumptions incorporated into the modelling in more detail. In England, the courts are expected to take a proactive approach to the valuation process.<sup>133</sup> However, this remains broadly left to the valuers and the parties to determine. This, it is contended, partly stems from the courts' reluctance to become involved in matters of commercial judgement.<sup>134</sup>

Leaving aside these general observations, the courts have extended their broad discretion in oppression matters to the methodology employed. In *Re Bird Precision Bellows Ltd*<sup>135</sup> and *Re Cumana Ltd*<sup>136</sup> the Court of Appeal emphasised that the choice of the valuation was very much a matter for the judge's discretion whilst a similar proposition was set out in *United Rural Enterprises Pty Ltd v Lopmand Pty Ltd and Ors* where the court noted that 'there is a broad discretion...as to the mode of valuation', noting though that 'if the case before a court is one which is similar to others which have been decided by the courts, the judge should take that into account in exercising his or her discretion.'<sup>137</sup>

Similarly, in *Smith Martis Cork & Rajan Pty Ltd v Benjamin Corporation Pty Ltd* the Full Federal Court of Australia stated conclusively that, 'the court has a wide discretion as to both the appropriate remedy and, if it orders compulsory acquisition of shares, as to the mode of valuation of the shares'.<sup>138</sup> Relevantly, the court retains a 'wide freedom to disregard the views of experts and apply the court's view as to what is fair in all the circumstances.'<sup>139</sup>

In *Re D G Brims and Sons Pty Ltd*,<sup>140</sup> Byrne J stated that the usual methods of valuing a shareholding in a closely held corporation are an assets based assessment,

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<sup>133</sup> *Bilkus v King & Anor* [2003] EWHC 2516 (Ch).

<sup>134</sup> Andrew Hicks and Alan Gregory, 'Valuation of Shares: a Legal and Accounting Conundrum' (1995) (Jan) *Journal of Business Law* 56, 56.

<sup>135</sup> [1984] 1 Ch 419.

<sup>136</sup> [1986] BCLC 430.

<sup>137</sup> (2003) 47 ACSR 514 [38] (Campbell J).

<sup>138</sup> [2004] FCAFC, [70].

<sup>139</sup> *Re Planet Organic Ltd* [2002] 1 BCLC 366, 370.

<sup>140</sup> (1995) 16 ACSR 559, 589.

capitalisation of maintainable earnings,<sup>141</sup> dividends return valuation, or a combination of these three methods. Similarly, Lord Millet in *CVC/Opportunity Equity Partners Ltd v Demarco Almeida* giving the judgement of the Privy Council held that:

[there] are essentially three possible bases... these are: (i) as a rateable proportion of the total value of the company as a going concern without any discount for the fact that the holding in question is a minority holding, (ii) as before but with such a discount; and (iii) as a rateable proportion of the net assets of the company at their break up or liquidation value. Which of these should be adopted as the appropriate basis of valuation depends on all the circumstances. The choice must be fair to both parties...<sup>142</sup>

There is general consensus, in both English and Australian judgements, that interests in a going concern should not be valued on a liquidation basis,<sup>143</sup> as this would give the purchaser a windfall at the expense of the seller, 'unless a notional liquidation would produce a higher valuation.'<sup>144</sup> For example where a company is technically insolvent and is not able to be 'valued on an earnings basis' it should be valued 'on an assets basis.'<sup>145</sup>

The court's approach in oppression matters to adopting a valuation methodology broadly aligns to that employed by valuers and by the courts in other judicial contexts. That is, the methodology should be selected based on an assessment of the underlying factual situations and the one that is most appropriate should be selected. No one methodology can be employed in all instances.

## XI WHAT IS THE APPROPRIATE DATE FOR THE VALUATION?

The initial principle set out in the English cases, such as *Re London School of Electronics Ltd*, referred to below, was that prima facie the interest should be valued on the date on which the purchase order was given or the date of the proceedings. Vinelott J in *Re Company* (No.002612 of 1984), held that he would "at least incline to the view that

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<sup>141</sup> See also *Re Quest Exploration Pty Ltd* (1992) 6 ACSR 659; *Coombs v Dynasty* (1994) 14 ACSR, *Smith Martis Cork & Rajan Pty Ltd v Benjamin Corporation Pty Ltd* (2004) 207 ALR 136.

<sup>142</sup> [2002] 2 BCLC 108.

<sup>143</sup> *CVC/Opportunity Equity Partners Ltd v Demarco Almeida* [2002] 2 BCLC 108, [38]; *Re Golden Bread Pty Ltd*; *The Queensland Co-operative Milling Association v Hutchinson* [1977] Qd R 44.

<sup>144</sup> *Mopeke Pty Ltd v Airport Fine Foods Pty Ltd* [2007] 61 ACSR 395, 423.

<sup>145</sup> *Re Golden Bread Pty Ltd*; *The Queensland Co-operative Milling Association v Hutchinson* [1977] Qd R 44, 53.

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the date of the petition is the correct starting point"<sup>146</sup> and "that a departure from this date must be justified on the ground of some special circumstances..."<sup>147</sup> This view is supported by Siranos when he stated that 'it would appear sensible to start with the date of presentation of the petition.'<sup>148</sup>

Initially, this approach was followed in Australia however from the mid-1990s it was acknowledged that there were many exceptions to this 'rule'. For example in *Coombs v Dynasty*, von Dousa J noted that there is however 'no firm rule that the commencement of proceedings is the appropriate date.'<sup>149</sup> Indeed White J in *Short v Crawley* rejected any such prima facie principle.<sup>150</sup> For this reason the courts had found a number of alternative dates for the valuation to occur:

- as at the date of the order;<sup>151</sup>
- as at the date of the proceedings;<sup>152</sup>
- immediately before the acts of oppression;<sup>153</sup> and
- date of last balance sheet.<sup>154</sup>

In the recent English case of *Profinance Trust SA v Gladstone*<sup>155</sup> the Court revisited the general rule. It held, citing Nourse J in *Re London School of Electronics Ltd*, that the appropriate date was the date of the purchase order it did recognise that there are many cases where 'fairness' to one side or the other requires to take a date for valuation other than the date of the purchase order.<sup>156</sup> However, as Cadman notes the

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<sup>146</sup> (1986) 2 BCC 99453, 99492.

<sup>147</sup> Ibid.

<sup>148</sup> Sirianos, above n 5, 106.

<sup>149</sup> (1994) 14 ACSR 60, 102.

<sup>150</sup> [2007] NSWSC 1322.

<sup>151</sup> *Re a Company (No 005134 of 1986) ex parte Harries; Richards v Lundy* [2000] 1 BCLC 376; *Re Regional Airports Ltd* [1999] 2 BCLC 959; *Re Lifemarque Ltd* LTL 2/12/2009; *Re D R Chemicals Ltd* (1989) 5 BCC 39; *Roberts v Walter Developments Pty Ltd* (1997) 15 ACLC 882; *Mopeke Pty Ltd v Airport Fine Foods Pty Ltd* (2007) 61 ACSR 254.

<sup>152</sup> *Scottish Co-operative Wholesale Society v Meyer* [1959] AC 324, 369; *Re Bread Ltd; The Queensland Co-operative Milling Association v Hutchinson* [1977] Qd R 44; *Re Dalkeith Investments Pty Ltd* (1984) 9 ACLR 247; *Sanford v Sanford Courier Service Pty Ltd* (1986) 10 ACLR 549; *Reid v Bagot Well Pastoral Company Pty Ltd* (1992) 9 ACSR 129, *Joint v Stephens* (2008) 26 ACLC 1,467.

<sup>153</sup> *Dynasty Pty Ltd v Coombs* (1995) 13 ACLC 1290.

<sup>154</sup> *United Rural Enterprises Pty Ltd v Lopmand Pty Ltd* (2003) 47 ACSR 514.

<sup>155</sup> [2002] 1 BCLC 141 [60].

<sup>156</sup> [1985] 3 WLR 474, [33]-[34].

courts 'are now prepared to be flexible over the date of valuation.'<sup>157</sup> In Australia, the current law is that 'there no restriction stated or implied...in fixing a date',<sup>158</sup> 'no hard and fast rule'<sup>159</sup> whilst the court's discretion is 'wide and absolute'<sup>160</sup> subject to the qualification that it be 'informed by the justice and fairness of the situation.'<sup>161</sup> In summary, the English and Australian positions are in agreement on this principle.

These exceptions do not mean that a petitioner is entitled to a 'one way bet' and the court will not direct a valuation date so to 'simply give the petitioner the most advantageous exit from the company'<sup>162</sup> or the minority shareholder has refused reasonable offers.<sup>163</sup>

## XII DISCOUNT FOR MINORITY HOLDING

As discussed above, it is normal commercial practice and is clearly understood in the marketplace that minority holdings are discounted from their pro-rata value as a consequence of the risks and disadvantages associated with them as outlined earlier. However, in most oppression cases, the court does not discount the value of the shares. The English courts have held that the 'general principle it is that no discount should be applied.'<sup>164</sup> Sirianos states that:

the principle is not only fair and reasonable but also eminently logical. To permit the majority to compulsorily acquire the minority interest at a price which reflects the effect of the oppressive conduct...would only provide the majority with a perverse incentive to oppress...<sup>165</sup>

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<sup>157</sup> John Cadman, *Shareholders' Agreements* (Sweet & Maxwell, 2004), 182. See also Joffe, above n 95, who states the English position is now that the 'choice of the date at which the shares are to be valued...is a matter for the exercise of the discretion of the trial judge, but the overriding requirement is that the date of valuation should be fair on the facts of the particular case'. *Re London School of Electronics Ltd* [1986] Ch 211, 224; *Profinance Trust SA v Gladstone* [2002] 141 [60].

<sup>158</sup> *United Rural Enterprises Pty Ltd v Lopmand Pty Ltd and Ors* (2003) 47 ACSR 514 [33] (Campbell J).

<sup>159</sup> *Re Quest Exploration Pty Ltd* (1992) 6 ACSR.

<sup>160</sup> (2007) 62 ACSR 576, 589.

<sup>161</sup> *Foody v Horewood* (2007) 62 ACSR 576.

<sup>162</sup> Joffe, above n 95, 341.

<sup>163</sup> *Profinance Trust SA v Gladstone* [2002] 141; *O'Neill v Phillips* [1999] 2 BCLC.

<sup>164</sup> *O'Neill v Phillips* [1999] 2 BCLC 1; *Re a Company (No 003843 of 1986)* [1987] BCLC 562, 566, 571.

<sup>165</sup> Sirianos, above n 5, 103.

The rationale for the no-discount rule is that the ‘transaction is not a market one but a judicial remedy’<sup>166</sup> and it would be unfair on the minority to sell their shares as if they had made a ‘free election’ to sell them.<sup>167</sup>

English cases,<sup>168</sup> and, to a similar degree, Australian cases, have considered that non-quasi partnership cases are more likely to be excluded from this general rule and the shareholding to be discounted ‘for what it is.’<sup>169</sup> The existence or absence ‘of a quasi-partnership relationship often has a determinative effect on the question of discount’,<sup>170</sup> or where ‘a “quasi-partnership” relationship has been found.’<sup>171</sup> In *O’Neill v Phillips*, Lord Hoffman stated ‘[t]his is not to say that there may not be cases in which it will fair to make a discounted value. But such cases will be based on special circumstances...’<sup>172</sup> Examples of these special circumstances include where rather than immediately seeking a purchase order, a minority shareholder elects to remain in the company as an investor,<sup>173</sup> or where the minority shareholder has through their own acts and omissions destroyed the value of the company.<sup>174</sup>

It is contended that this principle is too widely applied. If an investor elects to purchase a minority shareholding and their relationships with the majority sour to the extent that they are forced to commence litigation, whilst they should get the full value of their investment courtesy of ignoring the impact of the majority’s actions on the value of the company, the court selecting a date that is fair in the circumstances so as to maximise (or at least not unduly diminish) the value of the shares and the court using its broad discretion to otherwise form a proper valuation, the minority is effectively rewarded for commencing the action. Given the overwhelming commercial understanding that a minority shareholding is bought and sold at a discount to the pro-rata value of the shares, this rule should not apply to the oppression so liberally.

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<sup>166</sup> *Roberts v Walter Development Pty Ltd* (1997) 15 ACLC 906.

<sup>167</sup> *Re Bird Precision Bellows Ltd* [1984] 1 Ch 419, 430d (Nourse J).

<sup>168</sup> *Irvine v Irvine No 2* 1 BCLC 455; *Fowler v Gruber* [2009] CSOH 36 [181]; see also Joffe, above n 95, 333 citing *Re Bird Precisions Hollows Ltd* [1984] 1 Ch 419; *O’Neill v Phillips* [1999] 2 BCLC 1; *Re London School of Electronics Ltd* [1985] 3 WLR 474; *CVC/Opportunity Equity Partners Ltd v Demarco Almeida* [2002] 2 BCLC 108; *Parkinson v Eurofinance Group Ltd* [2001] 1 BCLC 720; *Croly v Good* [2010] EQHC 1 (Ch).

<sup>169</sup> *Campbell v Irvine (Holdings) Ltd No 2* [2007] 1 BCLC 455.

<sup>170</sup> Joffe, above n 95, 334.

<sup>171</sup> [2006] 2 BCLC 555 [17].

<sup>172</sup> [1999] 2 BCLC 1,16.

<sup>173</sup> *Re a Company (No 005134 of 1986) ex parte Harries* [1989] BCLC 383, 399a-399c.

<sup>174</sup> *Re McCarthy Surfacing Ltd* [2009] 1 BCLC 622 [95]-[99].

### XIII CONCLUSION

In summary, the English and Australian courts are in substance, aligned on the matters relevant to the valuation of minority shareholdings in oppression cases. Firstly, there is an overwhelming consensus that the court is vested with a broad discretion to do what is fair in the circumstances. This discretion extends to the selection of the methodology to be used in valuing the subject company and the date for the valuation to be conducted at. Arguably, there is some divergence between the jurisdictions on the premise upon which the remedy is founded. The majority of cases have focussed on doing what is 'fair in the circumstances' without at least acknowledging the compensatory nature of the remedy. The compensatory view, it is contended, better reflects both the court's purposes in this context and particularly, it justifies its approach to the matters underlying the valuation itself. This is particularly so in respect of the general principle that no discount is to be applied to the minority interest despite this being a fact of commercial life. Whilst it is agreed that the other factors in the valuation calculation should be determined broadly in favour of the petitioner to recover damages for the losses they have incurred due to the oppression, it should not be a general rule that their investments are valued at a pro rata level rather than for what they are (unless special circumstances exist).

Finally, if the initial principles are analysed and compared with the modern approach it is considered that the court's approach has broadened and is now founded in a number of broad discretions and there are very few, if any, starting points or principles that are consistently applied. Guidance may be taken from the various instances and factual scenarios but given the very nature of the valuation process combined with the ad hoc nature of small proprietary companies who are most often the subject of such proceedings, the court's modern approach should be preferred.