

UPDATE

Valuing minority shareholdings – must a minority discount be applied?

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Introduction

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Facts

The facts of this case are straightforward. A majority shareholder owned over 90 per cent of the shares in a BVI company (the **Company**), and a minority shareholder owned less than 10 per cent of those shares.

The majority shareholder caused the Company to initiate the process under section 176 of the BVI Business Companies Act, 2004 (the **Act**) of redeeming the minority shareholders' shares. Section 176 of the Act provides that, subject to a company's memorandum and articles:

- members of a company holding 90 per cent of the votes of the outstanding shares entitled to vote; and
- members of a company holding 90 per cent of the votes of the outstanding shares of each class of shares entitled to vote as a class,

may give a written instruction to the company directing it to redeem the shares held by the remaining members.

Having received this instruction, the Company sent the required notice to the minority shareholder, notifying him of the redemption of his shares and the proposed price to be paid for them. The minority shareholder did not accept the price offered for his shares, which triggered the valuation procedure under section 179 of the Act.

Section 179 of the Act provides that a member of a company is entitled to payment of the fair value of his shares upon dissenting from, amongst other things, a redemption of his shares by the company pursuant to section 176 of the Act.

Section 179(9) of the Act provides that if a company and its minority shareholder fail to agree on the price to be paid for the shares in question, then they shall each designate an appraiser, those two appraisers shall together designate a third appraiser, and between them, the three appraisers shall:

'fix the fair value of the shares owned by the dissenting member as of the close of business on the day prior to the date on which the vote of members authorising the action was taken or the date on which written consent of members without a meeting was obtained, excluding any appreciation or depreciation

directly or indirectly induced by the action or its proposal, and that value is binding on the company and the dissenting member for all purposes ...'

Dispute as to method of valuation

During the process of valuation, differences arose as to whether a minority discount should be applied to the value of the shares, to take account of considerations such as (as contended by the Company):

- '(a) the shares are highly illiquid, not readily capable of realisation by the [minority shareholder] and are at risk of compulsory redemption at the direction of the majority shareholder;
- (b) they confer no rights of control over any resolution of the Company's shareholders or directors; and
- (c) they do not confer a right to receive a distribution from the Company nor any power to compel the Company to make a distribution (per the shareholders agreement between the shareholders of the Company).'

On a preliminary assessment, if a minority discount was applied, this would result in a reduction of the value of the shares by around US\$9.8 million.

Company's claim for a declaration

In light of the dispute, the Company issued a claim, seeking various directions regarding aspects of the valuation process, including a declaration that:

'The fair value of the [minority shareholder's] shares, determined in accordance with s.179(9) (c) of the Act, **must** apply a discount for the minority or illiquid status.' [Emphasis added]

That claim was made under section 246 of the Act, which provides:

'A company may, without the necessity of joining another party, apply to the court, by summons supported by affidavit, for a declaration on any question of interpretation of this Act or the memorandum or articles of the company.'

At first instance, the BVI Court found that it did not have jurisdiction to grant the relief sought by the Company, because these were all matters for the experts' determination, not the Court.

Court of Appeal's decision

The Court of Appeal upheld the BVI Court's decision. It held that:

- Once a dispute falls within the terms of an expert's mandate he has jurisdiction to deal with it and the parties are bound by his decision.
- If the mandate does not contain principles and procedures for carrying out the valuation, and none are agreed by the parties, the expert will be free to determine how he proceeds and the Court will not intervene to tell him how to conduct the valuation, neither before nor after the valuation. The parties are bound by whatever he decides and the Court will intervene only if there is fraud or collusion.
- Where a dispute arises during the valuation process, the Court must decide firstly if the dispute falls within the expert's mandate. If it does, the Court should not intervene. If the dispute is jurisdictional, such as the interpretation of the expert's mandate, the Court must determine that issue, and it is a matter of procedural convenience whether it does so before or after the expert completes his work.

Applying those principles to the facts of the present case, the Court of Appeal found that the Court:

- has jurisdiction to declare that a minority discount **can** apply to a section 179(9) valuation; but
- does not have jurisdiction to declare that a minority discount **must** apply. That is an issue falling within the scope of the appraisers' mandate and thus one in respect of which the Court has no jurisdiction to intervene.

In response to the parties' request for general guidance as to whether a discount *should* apply to the minority shareholders' shares, the Court of Appeal observed that section 179(9) is silent on the application of the minority discount. It confirmed that where, as in this case, the parties did not agree as to whether such a discount should be applied, it then fell to the appraisers to decide 'whether one should be applied to the valuation of the [minority shareholder's] redeemed shares, and if it should, the details of how it should be applied.'

Other declarations

The Company also sought a raft of other declarations, relating to other aspects of the valuation process. In each case, the Court of Appeal held that the Court did not have jurisdiction to make those declarations, observing:

'The function of the Courts under section 179(9) is not to resolve non-existent or hypothetical disputes, nor to provide guidance to the Appraisers for doing their job under the section. If the Company had wanted these matters to be included in the Appraisers' mandate it should have included them in the Letter of Engagement.'

As the issue did not arise in this case, the Court of Appeal did not comment upon the approach to be taken if parties are unable to finalise a letter of engagement for their appraisers, and seek declarations at that stage.

Conclusion

This decision brings some welcome clarity on the application of minority discounts in compulsory redemption cases. It is now clear that such discounts can be applied, but that it is up to the expert appraisers to determine, on the facts of each individual case, whether such a discount *should* be applied.

Following a 30 January 2015 order by Bannister J in the same case, (and as mentioned with apparent approval by the Court of Appeal) it is also clear that appraisers' decisions should, in the absence of unanimity, be made by a majority of two out of the three appraisers.

This decision should give comfort to shareholders in BVI companies, both in relation to the procedure itself and the speed and efficiency with which any valuation should be conducted. Put simply, it allows appraisers to conduct their valuations without delay and/or concern that their discretion may be fettered by the Court, absent fraud, collusion or similar.

The Company is seeking permission to appeal.

Contacts



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