Neutral Citation Number: [2014] EWHC 2680 (Ch)
IN THE HIGH COURT OF JUSTICE **Petition No: 008880/2008**
CHANCERY DIVISION

COMPANIES COURT

IN THE MATTER OF BLUE INDEX LIMITED

AND IN THE MATTER OF THE COMPANIES ACT 2006

Before Mr R Hollington QC sitting as a Deputy Judge of the High Court

Hearing dates: 9-11, 14-16 July 2014

Judgment: 29 July 2014

Mr. Peter Knox QC, instructed by St John Legal, appeared for the Petitioner

Mr. Mallin, instructed by Irwin Mitchell, appeared for the 1st and 2nd Respondents

B E T W E E N: -

PAUL JOHN MURRELL

Petitioner

-and-

(1) JAMES ERNEST SWALLOW

(2) JAMES PAUL SANDERS

(3) BLUE INDEX LIMITED

Respondents

APPROVED JUDGMENT

I direct that pursuant to CPR PD 39A para 6.1 no official shorthand note shall be taken of this Judgment and that copies of this version as handed down may be treated as authentic.

……………………………………………

1. In the late 1990s the Petitioner (Mr. Murrell) and the 1st and 2nd Respondents, Mr. Swallow and Mr. Sanders, got to know each other well whilst working

together as traders at a firm called Everetts in the City of London. Everetts specialised in trading "penny shares", i.e. companies with very small market capitalisations, on behalf of clients. They were young men, aged respectively 29, 23 and 24 in 1998. And they earned a considerable amount of money, particularly at the height of the internet technology boom, which began dropping off in 2000.

2. Mr. Sanders and Mr. Swallow left Everetts in June 2000 in order to set up their own brokering business together, so as to enable clients to deal in what are called "contracts for differences", or CFDs for short. Dealing in CFDs is different from the ordinary business of investment by way of buying and selling quoted stocks and shares and other commodities and financial instruments. A CFD is a derivative product which enables a client to go "long" or "short" in a stock or financial instrument, i.e. speculating that the price of a particular stock will go up (long) or down (short). Furthermore, partly it appears because the holding of a CFD will invariably be short-term, facilities are made available to the client enabling it to "leverage" its position, i.e. giving the client access to capital beyond the capital ventured by the client from its own resources. Thus, it was a high-stakes and high-risk business for the client who needed to be highly sophisticated and knowledgeable, and, I would add, who should be able to afford losing a lot of money very quickly. And a risk-averse client could always "hedge" its position, thus limiting the risk. Mr. Murrell described this form of speculation as the equivalent of on-line gambling, but I think that probably goes too far. Dealing in CFDs was just a particularly sophisticated, high risk, high stakes version of investment. I suppose it was also a useful get-rich quick mode of investment for the unscrupulous who might think they had inside information. In any event, it was a regulated form of investment.
3. The business that Mr. Sanders and Mr. Swallow set up was Blue Index Limited, which I will refer to as "the Company". It was an introducing broker. It had arrangements with CFD market-makers which enabled its clients to deal in CFDs. The Company's income would be derived principally from the commissions payable by its clients on deals. And it was to be a ruthless selling business: its traders were remunerated solely by way of commissions they earned on the commissions they earned for the Company. The traders' job was to attract as many clients as possible and to get them to deal as much as possible. And, obviously, the more money they made for their clients, the more successful they would be. It was a beautifully simple, and potentially highly lucrative, business model. None of its key personnel, that is to say its traders, would earn anything so mundane or as secure as a monthly salary. But, also obviously, it required effective management and leadership.
4. The Company was established with an issued share capital of 75,000 ordinary shares of £1 each, held equally by Mr. Sanders and Mr. Swallow, who were its directors.
5. Mr. Murrell, having left Everetts in 2001, joined the Company's staff and became a shareholder in the Company on 29 April 2002. The Company had barely started to trade by that date and its future prospects were wholly uncertain. Its liabilities almost certainly exceeded its assets. The circumstances in which he did so constitute the key issue in this case, to which I will return. But suffice to

say for the present introductory purposes, Mr. Sanders and Mr. Swallow each sold him 1,125 shares, making him a 3% shareholder, and Mr. Sanders and Mr. Swallow each thereafter held 48.5% of the shares. In theory, therefore, there was thereafter no majority shareholder. In the documentation which accompanied the share sale to Mr. Murrell, the purchase price was recorded as £2,250, i.e. par. In fact, Mr. Murrell paid Mr. Sanders and Mr. Swallow the agreed sum of £45,000, plus a small additional sum in respect of stamp duty on the transfers. The parties gave different accounts, to which I will return, of why the recorded share purchase price was par.

6. The Company's articles of association contained standard pre-emption provisions, obliging any shareholder desirous of transferring his shares to a non-member to offer them to existing shareholders at a price determined by the auditors as their "fair value".
7. In June 2002, unknown and without reference to Mr. Murrell, Mr. Sanders and Mr. Swallow caused a further 1,000 shares to be issued to themselves. It appears that this arose out of a need to raise further capital to satisfy a regulatory requirement.
8. The parties fell out very rapidly and Mr. Murrell was summarily dismissed on 24 October 2002. Negotiations for the sale back of his shares commenced but they did not progress with any speed.
9. In June 2003 Mr. Sanders and Mr. Swallow, again without reference to Mr. Murrell, caused the articles of association of the Company to be changed, which appeared to have the effect of converting Mr. Murrell's shares into non-voting shares and cutting him out of the benefit of the pre-emption provisions in the event that Mr. Sanders and Mr. Swallow wished to sell their shares. At the same time they executed a Shareholders Agreement between themselves dated 4 June 2003.
10. To cut a long story short, Mr. Murrell eventually presented this petition, seeking an order for the purchase of his shares, in November 2008. It appears that the Financial Services Authority arrested Mr. Sanders and Mr. Swallow on suspicion of insider dealing offences and closed the Company down in May 2009. They pleaded guilty to these offences in June 2012 and were sentenced to terms of imprisonment. The Company was dissolved on 23 July 2013.
11. Mr. Knox QC, Counsel for Mr. Murrell, submitted that I should take this criminal conduct into account in assessing the credibility of Mr. Sanders and Mr. Swallow as witnesses. I decline to do so. In my view, since I know very little about these offences, it would be wholly unfair for me to take them into account. Furthermore, all these events occurred after the agreed date of valuation, namely 1st November 2006. I will ignore them completely.
12. Mr. Mallin, Counsel for Mr. Sanders and Mr. Swallow, submitted that I should take into account in the valuation the fact that the Company had ceased to trade in May 2009, so that there would in fact in this case be no unjust enrichment of Mr. Sanders and Mr. Swallow if a discount for a minority shareholding were applied in this case. I will return to this point below.
13. It has already been ordered, by paragraph 1 of the order of Registrar Derrett dated 9 July 2009, that Mr. Sanders and Mr. Swallow do purchase Mr. Murrell's shares at a price to be determined by the Court. That paragraph 1 provided as

follows: "*There be judgment for the petitioner on the first and second claims at paragraphs 15 to 31 of the Petition; ..*". As Mr. Mallin rightly accepted, this meant that the averments made in those paragraphs of the Petition must be treated as having been established to the satisfaction of this Court. Thus, I proceed on the following basis:

(1) The issue of 1,000 shares in 2002 to Mr. Sanders and Mr. Swallow entailed a "*deliberate*" breach of their fiduciary duties as directors.

(2) The change to the articles of association in 2003 was "*intended*" by them to be prejudicial to Mr. Murrell's interests. Further, they were "*motivated by a desire to destroy the value of [Mr. Murrell's] shareholding*".

(3) No AGM has ever taken place, contrary to section 366 of the Companies Act 1985.

(4) "*[T]he Petitioner cannot reasonably be expected to remain a member of the Company given the deliberately hostile nature of the unfairly prejudicial conduct [of Mr. Sanders and Mr. Swallow]..*"

14. It has also been agreed that the date of valuation of Mr. Murrell's shares shall be 1st November 2006. I am not therefore concerned with events after that date, save so far as it is proper to take them into account under ordinary valuation principles.

<u>The issues in this case</u>

15. The principal issue that I therefore have to determine is the fair and appropriate value to place on Mr. Murrell's shares as at 1st November 2006. It is common ground that for this purpose I should proceed on the basis that Mr. Murrell holds 3% of the Company's issued share capital.
16. It is Mr. Murrell's case that his shares should be valued without any discount for a minority shareholding. Mr. Sanders and Mr. Swallow submit that such a discount should be applied. I heard a great deal of evidence and lengthy submissions from the parties on this issue.
17. The parties have each adduced evidence from share valuation experts. As is unfortunately common in cases such as this, and this may well be due at least in part to a degree of uncertainty as to the legal principles which govern issues of share valuation, the experts are a long way apart, even making allowance for the question whether a discount for a minority shareholding should be applied. One of the main differences between the experts is as to a proper and commercial level of remuneration payable for the services rendered to the Company by Mr. Sanders and Mr. Swallow. They also differed completely in other respects as to the other businesses which could be used as comparables in this case, and as to the risks which had to be taken into account in assessing the multiplier to be applied to the earnings or dividend yield.
18. There is a further issue which I need to determine, and that is Mr. Murrell's claim that Mr. Sanders and Mr. Swallow breached their fiduciary duties as directors in causing the Company to pay themselves excessive salaries and the shareholders inadequate dividends from September 2003 until September 2007.

<u>Valuation principles – discount for minority shareholding</u>

19. I propose to begin by setting out the principles which I propose to apply in this case. Out of deference to the full argument before me, I will deal with the issue at some length.
20. The starting point is the very well-known decision of the Court of Appeal in Re Bird Precision Bellows [1986] Ch. 658, approving the judgment of Nourse J (as he then was) [1984] Ch. 419.
21. In his classic judgment in the Court of Appeal, Oliver LJ (as he then was) began his analysis of the law by making the following fundamental point:

"The court, in other words [so the respondents submit], is to be rigidly restricted, if it is to make an order under section [996(2)] at all, to making an order for a purchase at a market price of the holding being purchased, to be arrived at only by the ordinary valuation principles, which will take into account the proportionate size of the holding in relation to the issued capital as a whole and to the control of the company.

For my part I find myself quite unable to accept this submission. It seems to me that the whole framework of the section, and of such of the authorities as we have seen, which seem to me to support this, 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, in order to put right and cure for the future the unfair prejudice which the petitioner has suffered at the hands of the other shareholders of the company; and I find myself quite unable to accept that that discretion in some way stops short when it comes to the terms of the order for purchase in the manner in which the price is to be assessed." [page 669]

Thus, the task of the Court, in granting relief, is first to identify the unfair prejudice which has been established and then to fashion the relief so as to cure that prejudice. That principle must underlie the issue whether or not a discount for minority shareholding should be applied.

22. In upholding the finding in the court below that no discount for a minority shareholding should be applied, Oliver LJ cited with approval the reasoning of Nourse J, in a passage [pages 666-668] which it is worth setting out in full:

"The basis of the judge's valuation is to be found in two passages from the judgment, at pp. 429 and 430: and there is a further passage at p. 431. The judge said, at pp. 429-430:

> *"Although both sections 210" - which of course was the predecessor of section 75 [and 994] - "and 75 are silent on the point, it is axiomatic that a price fixed by the court must be fair. While that which is fair may often be generally predicated in regard to matters of common occurrence, it can never be conclusively judged in regard to a particular case until the facts are known. The general observations which I will presently attempt in relation to a valuation of shares by the court under section 75 are therefore subject to that important reservation. Broadly speaking, shares in a small private company are acquired either by allotment on its incorporation or by transfer or devolution at some later date. In the first category it is a matter of common occurrence for a company to be incorporated in order to acquire an existing business or to start a new one, and in either event for it to be a vehicle for the conduct of a business carried on by two or more shareholders which they could, had they wished, have carried on in partnership together. Although it has been pointed out on the high authority to which I will soon refer that the description may be confusing, it is often*

convenient and it is certainly usual to describe that kind of company as a quasi-partnership. In the second category, irrespective of the nature of the company, it is a matter of common occurrence for a shareholder to acquire shares from another at a price which is discounted because they represent a minority holding. It seems to me that some general observations can usefully be made in regard to each of these examples."

Nourse J. then referred to the well known passage from the speech of Lord Wilberforce in In re Westbourne Galleries Ltd. [1973] A.C. 360 , 379, and went on:

"His Lordship, having observed that it is not enough that the company is a small one, or a private company, identified three typical elements, one, or probably more, of which will characterise the company as a quasi-partnership. They are, first, an association formed or continued on the basis of a personal relationship involving mutual confidence; secondly, an agreement or understanding that all or some of the shareholders shall participate in the conduct of the business; and, thirdly, restrictions on share transfers. No doubt these three elements are the most familiar, and perhaps the most important, but they were not intended to be exhaustive. In my view there may be other typical and important elements, in particular the provision of capital by all or some of the participants."

Next comes a passage which I think has assumed some importance in the argument, so perhaps it is worth reading:

"I would expect that in a majority of cases where purchase orders are made under section 75 in relation to quasi-partnerships the vendor is unwilling in the sense that the sale has been forced upon him. Usually he will be a minority shareholder whose interests have been unfairly prejudiced by the manner in which the affairs of the company have been conducted by the majority. On the assumption that the unfair prejudice has made it no longer tolerable for him to retain his interest in the company, a sale of his shares will invariably be his only practical way out short of a winding up. In that kind of case it seems to me that it would not merely not be fair, but most unfair, that he should be bought out on the fictional basis applicable to a free election to sell his shares in accordance with the company's articles of association, or indeed on any other basis which involved a discounted price. In my judgment the correct course would be to fix the price pro rata according to the value of the shares as a whole and without any discount, as being the only fair method of compensating an unwilling vendor of the equivalent of a partnership share. Equally, if the order provided, as it did in In re Jermyn Street Turkish Baths Ltd. [1970] 1 W.L.R. 1194 , for the purchase of the shares of the delinquent majority, it would not merely not be fair, but most unfair, that they should receive a price which involved an element of premium."

Then, Nourse J. said, at p. 431:

"Next, I must consider the example from the second category of cases in which, broadly speaking, shares in a small private company are acquired. It is not of direct relevance for present purposes, but I mention it briefly in order finally to refute the suggestion that there is any rule of universal application to questions of this kind. In the case of the shareholder who acquires shares from another at a price which is discounted because they represent a minority it is to my mind self-evident that there cannot be any universal or even a general rule that he should be bought out under section 75 on a more favourable basis, even in a case where his predecessor has been a quasi-partner in a quasi-partnership. He might himself have acquired the shares purely for investment and played no part in the affairs of the company. In that event it might well be fair - I do not know - that he should be bought out on the same basis as he himself had bought, even though his interests had been unfairly prejudiced in the meantime. A fortiori, there could be no universal or even a general rule in a case where the company had never been a quasi-partnership in the first place."

Nourse J. said, in summary, that there is no general rule and then comes the passage to which particular criticism has been directed:

> *"On the other hand, there is a general rule in a case where the company is at the material time a quasi-partnership and the purchase order is made in respect of the shares of a quasi-partner. Although I have taken the case where there has in fact been unfairly prejudicial conduct on the part of the majority as being the state of affairs most likely to result in a purchase order, I am of the opinion that the same consequences ought usually to follow in a case like the present where there has been an agreement for the price to be determined by the court without any admission as to such conduct. It seems clear to me that, even without such conduct, that is, in general, the fair basis of valuation in a quasi-partnership case, and that it should be applied in this case unless the respondents have established that the petitioners acted in such a way as to deserve their exclusion from the company."*

23. In my view it is reasonably clear that the distinction that Nourse J was drawing between the two categories of case for the purpose of his exposition of the underlying principle, i.e. as to whether or not a discount for a minority shareholding was applicable, was a distinction between the general case where it was unfair to treat the wronged petitioner as a willing seller and therefore for the price to be fixed on a discounted basis, and the exceptional case where it was fair to do so because (for example) he had acquired his shares at a discounted price. In other words, the emphasis in his exposition of the underlying principle lay in the unfairess in treating a successful petitioner as a willing seller. Nourse J was not drawing a distinction between a quasi-partnership and a non quasi-partnership, because it would have been easy for him to express himself to that effect and he did not. For the purposes of his exposition of the underlying principle, the quasi-partnership case was the case where typically the wronged petitioner could not be treated as a willing seller (to the contrary where he had deserved his exclusion) or as having acquired his shares at a discounted price.
24. The matter may be tested by taking the example of a non quasi-partnership case where shares have been acquired on a full pro rata basis without any discount for a minority shareholding. Suppose the minority shareholder has been seriously wronged and prejudiced such as to justify relief on the oppression ground, whether it be by way of a share purchase order or, in the absence of such a remedy, a winding up order. It would be just as unfair to the wronged minority shareholder in such a case for his shares to be purchased by the oppressing majority with a discount for a minority shareholding as it would be if it were a quasi-partnership case. Take further, by way of contrast, the quasi-partnership case where shares have nevertheless clearly been acquired at a discounted price. Such a case would fall into the second category in the analysis of Nourse J, as was indeed noted by Peter Gibson J (as he then was) in <u>Re a company (No. 005134 of 1986), ex parte Harries</u> [1989] BCLC 383, discussed below.
25. In other words, I can see nothing in the fact that the case is a quasi-partnership one for that to be the determining factor as to the general applicability of a discount for a minority shareholding.

26. It may be objected, as it was argued unsuccessfully before the Court of Appeal in Re Bird Precision Bellows [1986] Ch. 658, that this ignores the reality that the shareholding to be purchased is a minority shareholding. But that argument was rejected. And it is in my view a fallacious one, since the whole purpose of the unfair prejudice remedy is to grant the oppressed minority a remedy which it would not otherwise have. It would substantially defeat the purpose of the new remedy if the oppressing majority were routinely rewarded by the application of a discount for a minority shareholding.

27. I am fortified in this reading of Re Bird Precision Bellows by the speech of Lord Hoffmann in the leading case in this field, O'Neill v. Phillips [1999] 1 WLR 1092 (H.L.). As to the application of a discount for a minority shareholding, Lord Hoffmann held:

> *"In the first place, the offer must be to purchase the shares at a fair value. This will ordinarily be a value representing an equivalent proportion of the total issued share capital, that is, without a discount for its being a minority holding. The Law Commission (paragraphs 3.57–62) has recommended a statutory presumption that in cases to which the presumption of unfairly prejudicial conduct applies, the fair value of the shares should be determined on a pro rata basis. This too reflects the existing practice. This is not to say that there may not be cases in which it will be fair to take a discounted value. But such cases will be based upon special circumstances and it will seldom be possible for the court to say that an offer to buy on a discounted basis is plainly reasonable, so that the petition should be struck out." :* at 1107D-E.

28. It is clear to my mind that in that passage Lord Hoffmann regarded such a discount as appropriate only in "special circumstances" and that the general rule was no discount, regardless of whether it was a quasi-partnership case. Paragraph 3.57 of the Law Commission Report was, it is true, directed to the case where a quasi-partner had been removed from office as a director, but Lord Hoffmann did not confine his statement of principle to such a case. Indeed, the case before Lord Hoffmann was one where it made no difference to the result that the company was a quasi-partnership, and it was not one where the petitioner had been removed from office as a director. Had the petitioner's case succeeded, it would not have succeeded because the company was a quasi-partnership but because the promises upon which the petitioner relied were held to be binding in equity. In those circumstances, it is inconceivable in my view that Lord Hoffmann, in this section of his speech, was intending to confine his remarks as to the appropriate application of a discount for a minority shareholding to quasi-partnership cases.

29. Lord Hoffmann's remarks may have been *obiter* but they had clearly been carefully thought through and were fully reasoned. I regard them as binding on me and in any event entirely in keeping with the judgment of Oliver LJ in Re Bird Precision Bellows on this issue, which is also binding on me.

30. Mr. Mallin, counsel for Mr. Sanders and Mr. Swallow, ably and forcefully submitted to me that the general rule, in non-quasi-partnership cases such as the present, was that a discount for a minority shareholder was applicable, whether or not Mr. Murrell had acquired his shares at a discounted price. He referred me in particular to three cases, Re a company (No. 005134 of 1986), ex

parte Harries [1989] BCLC 383, Strahan v. Wilcock [2006] 2 BCLC 555 (C.A.), and Irvine v. Irvine (No 2) [2007] 1 BCLC 445.

31. In Re a company (No. 005134 of 1986), ex parte Harries [1989] BCLC 383, Peter Gibson J (as he then was) held that, where a quasi-partner had elected to remain a shareholder rather than seeking a share purchase order after he had been wrongfully excluded from the company, and had subsequently been wrongfully and flagrantly prejudiced, he was only entitled to be bought out on a discounted basis. That decision has stood, unchallenged, for many years.

32. On closer inspection, however, in my view this case provides support for my understanding of Re Bird Precision Bellows. The Judge explained his decision that a discount was appropriate in that case in the following terms at pages 398-399:

> *"However, in relation to the first question, in Re Bird Precision Bellows Ltd. [1984] Ch. 419; (1984) 1 BCC 98,992 Nourse J. stated at p. 431; 98,997 that there was a general rule in a case where the company is at the material time a quasi-partnership and the purchase order is made in respect of the shares of a quasi-partner and that rule is that the aggrieved quasi-partner should not be bought out on a basis which involves a discounted price but should receive a pro rata price as being the only fair method of compensating an unwilling vendor for the equivalent of a partnership share. Nourse J. contrasted such a case with that where the holding to be purchased is that of a shareholder who at a later date than incorporation buys a minority holding at a discount to reflect the fact that it is a minority holding.* ***In the latter case he suggested that it might be fair that the shareholder be bought out at a discount even if the company is a quasi-partnership.*** *Mr. Davis submitted that the present case is one of a quasi-partnership or akin to such a case and that the pro rata basis is therefore appropriate. Mr. Crow submitted that the present case fell within the second category of cases to which Nourse J. referred and that a discount basis is appropriate. There is no valuation evidence before me on which I could safely reach any conclusion on whether or not Mr. Harries acquired his shares at a discount to reflect his minority holding in 1977. Nor does it seem to me that after August 1982 it would be right to treat the company as being in any sense a quasi-partnership company. Mr. Harries might at that date have sought relief from the court on the footing that the company was a quasi-partnership. He elected not to do so and instead chose to sit it out as an ordinary minority shareholder. Accordingly I am not prepared to apply Nourse J.'s general rule.*
>
> *I approach the matter somewhat differently. Mr. Harries is a minority shareholder seeking a fair price for his shares. In the absence of any special features the value of his shares must reflect the fact that his holding is only a minority holding, though an important minority holding enabling the holder to block all resolutions other than one requiring a bare majority of votes. I cannot see that after his election he could have obtained a winding-up order in order to receive a rateable share of the company's assets. Neither the previous history of the company nor the parties' conduct requires as a matter of fairness a sale on the pro rata basis, given the fact of his election. Accordingly in my judgment the discounted basis of valuation is appropriate."* [emphasis added]

33. Thus, Peter Gibson J understood the exposition of general principle by Nourse J in Re Bird Precision Bellows as one based on the question whether the

petitioner had acquired his shares on a discounted basis, rather than one based on the existence of a quasi-partnership. For the reasons he gave, he approached the matter on a different basis, namely whether or not the petitioner was entitled to a winding up order. So this case shows that a Court has a wide discretion, and may apply a discount depending upon whether it regards the petitioner as entitled to a winding up order.

34. In Strahan v. Wilcock [2006] 2 BCLC 555 (C.A.), Arden LJ referred at paragraph 1 to the decisions of Re Bird Precision Bellows and O'Neill v. Phillips. The issues before the Court of Appeal in that case were, first, whether the case was one of quasi-partnership and, secondly, whether, if the general rule of no discount applied, it was displaced in the special circumstances of that case. It was held that the case was one of quasi-partnership and that there was no sufficient reason to depart from the general rule of no discount. In that respect, this case is consistent with my understanding of Re Bird Precision Bellows. It is true to say that some of her Ladyship's remarks in paragraph 17 of her Judgment, upon which Mr. Mallin placed great reliance, are seemingly inconsistent with that understanding:

> *"... Shares are generally ordered to be purchased on the basis of their valuation on a non-discounted basis where the party against whom the order is made has acted in breach of the obligation of good faith applicable to the parties' relationship by analogy with partnership law, that is to say where a "quasi-partnership" relationship has been found to exist. It is difficult to conceive of circumstances in which a non-discounted basis of valuation would be appropriate where there was unfair prejudice for the purposes of the 1985 Act but such a relationship did not exist. However, on this appeal I need not express a final view on what those circumstances might be."*

But this passage is plainly obiter. It is far from clear what conclusion Arden LJ would have reached had it been necessary for her to decide the issue.

35. In Irvine v. Irvine (No 2) [2007] 1 BCLC 445, and a number of other first instance cases including the Scottish case of Fowler v Gruber [2010] 1 BCLC 563, it has been held, following paragraph 17 of the judgment in Strahan v. Wilcock and a passage in the judgment of the Privy Council (Lord Millett) in CVC/Opportunity Equity Partners Ltd. v. Demarco Almeida [2002] 2 BCLC 108 (at [41]), that the general principle is that, apart from quasi-partnership cases, a minority shareholding is to be valued "as it is" with a discount.

36. I am faced, therefore, with what I see as a conflict of authority. Do I follow more recent cases such as Irvine v. Irvine (No 2), or do I follow my above clear understanding of Re Bird Precision Bellows and O'Neill v. Phillips? In my view I am free and indeed obliged to take the latter course. But, I will also state my conclusions if the law is as stated in Irvine v. Irvine (No 2).

37. I was also referred to a recent decision of HH Judge Purle QC in Re Sunrise Radio Ltd [2009] EWHC 2893 (Ch), relied upon by Mr. Knox QC, Counsel for Mr. Murrell. The reasoning of the learned Judge at paragraphs 289 to 308 differs in many respects from my own, but provides some support nevertheless.

38. I would add that I was also referred to an interesting article intituled "The valuation of Minority Shareholdings in an Oppression Context – a contemporary review" by Richard Brockett published in (2012) 24.2 Bond Law Review pages 101-124. Again, this article provides some support for my understanding of Re

Bird Precision Bellows, O'Neill v. Phillips and the Harries case. I would also note the following passage at pp. 115-116, which is relevant in the general context of share valuation:

> "…. [*T]he effect of the oppressive conduct which has occurred [should be disregarded.] This is non-contentious. This approach was echoed by Young J in ES Gordon Pty Ltd v. Idemeneo (No 123) Pty Ltd where a further qualification was noted that in determining value, if there was any uncertainty then any erring should be 'on the side of the oppressed'.*"

But this should not in my view be carried too far. Minority shareholders may be tempted to view the future prospects of businesses through rose-tinted glasses and underestimate the risks attendant in any business venture. In my view this is of particular relevance to a business such as the present one. Those who make a lot of money quickly with a simple business model in a services field, like Mr. Sanders and Mr. Swallow, are undoubtedly very gifted but they tend to attract the attention of other equally able and younger and hungrier entrepreneurs eager to emulate their success.

The facts

39. I heard extensive evidence from the three principal protagonists in this case. I have to say that I found Mr. Murrell a disarmingly honest if somewhat emotional witness and preferred his evidence to that of Mr. Sanders and Mr. Swallow. In three specific respects, I regret to say that I found their evidence unreliable. The first respect was their evidence as to how the price for Mr. Murrell's shares came to be expressed in the paperwork as £2,250 rather than what was actually paid, namely £45,000. Mr. Murrell stated in so many words that he wanted the paperwork to express the reality but that Mr. Sanders and Mr. Swallow insisted on the lower figure. That struck me as broadly accurate and truthful: the lower value benefited them for tax reasons. They, on the other hand, both said in their witness statements that the figure inserted in the paperwork was a mistake. In cross-examination, that evidence changed: they both said that what they had meant was that it was deliberate but that it turned out subsequently to be a mistake from a tax point of view. I simply cannot accept their evidence in this respect. The second respect was their treatment of Mr. Murrell in relation to the change of articles in 2003. I have no doubt that thereby they deliberately, and frankly in bad faith, sought to put pressure on Mr. Murrell, at a time when there were desultory negotiations for his shares to be purchased. The 2003 accounts, and the Shareholders Agreement dated 4 June 2003 which they executed, show clearly that they regarded themselves as the beneficial owners of the entire issued share capital of the Company. I can think of no excuse for this behaviour on their part, other than that it did not succeed as they soon recognised in 2004 when on 1 April 2004, probably belatedly (they could not say when the 2nd interim dividend was paid to them), they paid Mr. Murrell his 2nd interim dividend, together with his final dividend for that year. The third respect in which I was troubled by their evidence was their insistence that they were under no personal financial pressure at the time that they sold the 3%

shareholding to Mr. Murrell on 29 April 2002. In my view, it was likely that they were under some financial pressure because otherwise they would never have agreed to part with such a shareholding, which gave Mr. Murrell a lot of power in the event that they ever fell out with each other, and they held out for such a large price for the shares which can only at that stage have been based on hope value. There is clear evidence that they had to borrow substantial sums of money in order to meet the set-up costs of the new business, and I cannot accept, in the absence of hard evidence, that they had adequate cash resources at that time. I do not know whether the £45,000 from Mr. Murrell was used to pay back their borrowings, but it must have relieved to a significant extent their financial stress.

40. So I accept Mr. Murrell's evidence to the extent that, prior to his investment, the three of them talked about the retention of profits and payment of dividends in the future. I accept Mr. Murrell's evidence that he saw no need for these discussions to be incorporated in an express term of the shareholders' agreement that they entered into – I accept his evidence that his investment was based in large part on the relationship between the three of them being one of trust and confidence. It was common ground that his investment was a long-term one. However, in my view these discussions did not result in anything remotely approaching an agreement of sufficiently precise content to be enforceable in law or equity. In my view, it is likely that these were no more than very general discussions which could not easily have been reduced to writing and gave rise to no more than a duty of good faith on the part of Mr. Sanders and Mr. Swallow. In particular, I do not think it likely that Mr. Sanders and Mr. Swallow ever said expressly that they would only draw nominal salaries, and in cross-examination I do not think that Mr. Murrell maintained that they had.

41. I also do not accept Mr. Knox's submission that Mr. Murrell was to have sole responsibility under his service contract for business development. In my view, there was nothing stopping the Company from appointing a further member of staff with parallel responsibility, as happened.

42. That leads me on to the evidence as to the circumstances in which the Company did pay remuneration to Mr. Sanders and Mr. Swallow and dividends. Under their service contracts, they were not entitled to fixed annual salaries but instead to "such salary as [the Company] sees fit". Regulations 82 and 84 of Table A (1985) applied to the Company. By Regulation 84, the board were authorised to "remunerate any …. director for his services as they fit". In my view, this article authorised the board to set their salary for the purposes of their service contracts. And this is what happened. Every year, on their own evidence they drew by way of salary whatever they considered it was proper for the Company to pay them having regard to its liabilities and future running costs, and I would add only mentioning in their evidence these factors, and at the end of the year, when the board came to approve the accounts, the remuneration they had paid themselves was formally ratified. Provided that they complied with their fiduciary duties in setting their own remuneration, I can see no valid objection to this method which they adopted for their own remuneration. Mr. Knox submitted that a "salary" had to be something set in advance and not fixed

on an ad hoc basis depending upon the profits, as happened here. I reject this submission: in a company such as this, where a fixed salary was excluded, any other interpretation of their service contracts would lack commercial sense. I also reject his submission that their service contracts did not permit the payment of pension contributions for their benefit – in my view pension contributions can in ordinary commercial parlance be regarded as one way in which remuneration can properly be paid to directors.

43. The primary issue, therefore, is whether Mr. Sanders and Mr. Swallow did comply with their fiduciary duties as directors when deciding how much they should be paid for their services. They claimed that they had received and followed tax advice to the effect that they should ensure that the profits after payment of their remuneration did not exceed £300,000, up to which corporation tax was payable at a reduced rate. I cannot accept their evidence in this respect. There is not a single document which supports the giving of such advice. No evidence was adduced from their auditors that they gave such advice. It was put to them that, at least up to turnover of £1million, it was tax advantageous for everyone if they kept their salaries to £30,000 per annum and paid the rest in dividends. Mr. Murrell's valuation expert, Mr. Faull, provided the material calculations in paragraph 4.2 of his 1st report, and nobody suggested that this was not a compelling case. If they had sought tax advice, it is likely in my view that this is the sort of broad advice they would have received – detailed tax advice might have made qualifications, such as if they needed to show a higher degree of remuneration for the purpose of getting a mortgage or putting aside pension contributions, but neither of them said that these had been factors in their minds in fact. So, I am sceptical about their evidence as to how they approached the issue of the proper level of their remuneration and the advice they claimed to have been acting on.

44. I also take into account what they in fact did in the financial year ended 30 September 2003, whose accounts were approved by them on 18 November 2003. As I have already found, those accounts show that they were proceeding on the basis that they were 100% shareholders. And in that year, on a turnover of £1,127,800, they paid themselves salaries in the aggregate amount of about £113,000 (i.e. about 10% of turnover), as against interim dividends of £119,000 (again about 10% of turnover) and a final dividend of £53,000 (about 5% of turnover). Profit before tax in that year was £336,667 – i.e. even though the Company paid corporation tax at the higher rate above £300,000, everybody was better off in financial terms and the HMRC was worse off.

45. I also take into account the fact that Mr. Sanders and Mr. Swallow were in an obvious and serious position of conflict of interest in determining their own salaries, without consultation with Mr. Murrell and without the benefit of professional advice. It was not suggested by Mr. Knox that that fact of itself invalidated what they decided, because of the effect of Regulations 85-86 Table A (1985). Nevertheless, the fact that they were in such a serious conflict situation is a matter which I may properly take into account in determining whether they complied with their fiduciary duties in determining their level of remuneration.

46. And finally, I also take into account the findings of fact I have already made as to the credibility of Mr. Sanders and Mr. Swallow as witnesses, particularly their bad faith in relation to the change of the articles in 2003.
47. Taking all the above factors into account, I find on the balance of probabilities that they breached their fiduciary duties as directors in determining their own remuneration. I do not think they consciously acted in bad faith in this respect, in contrast to my finding as to the 2003 change of articles, but rather that in this context they failed to direct their minds properly or at all to the interests of the Company, that is to say the interests of the shareholders as whole. From the financial year ending 30 September 2004 onwards, they thought they could pay themselves whatever they thought was proper remuneration for their services and in so doing only took into account the liabilities of the Company and its on-going expenses. I shall return to the issue of what remedy is appropriate in order to compensate Mr. Murrell for this important failing on their part.

<u>The valuation of Mr. Murrell's 3% shareholding</u>

Discount for minority shareholding

48. I should first make it clear that by "discount for a minority shareholding" I am referring to the discount that should be applied to reflect the lack of control that a minority shareholder has over the management of a company in contrast to the control that a larger shareholder has. The smaller the shareholding, the less the control. Thus, a 49% shareholder cannot stop the passing of an ordinary resolution and has no control over the composition of the board, but can stop the passing of a special resolution. A 24% shareholder cannot stop the passing of a special resolution. A 9% shareholder is vulnerable to being bought out compulsorily in the event of a take-over bid.
49. Thus, one is not talking in this context about other discounts which are often applied in share valuations, such as discounts for the non-marketability of 100% shareholdings in private companies.
50. It goes without saying that in the context of the unfair prejudice remedy, one does not value a minority shareholding on the basis of what its market value is: in the real world, a minority shareholding in a private company has very little value because there is virtually no market for such a thing.
51. For the reasons I have already given, in my view the general rule is that there should be no discount for a minority shareholding unless Mr. Murrell acquired his shares at a discounted price in the first place. In my view, it is clear that, far from acquiring his shares at a discounted price, he acquired them at a substantial premium to any value that could be reliably put on the Company at the end of April 2002. Further, £45,000 was in my view on any basis a substantial sum of money from the point of view of all three parties in the circumstances which prevailed then. I conclude therefore that there should be no discount for a minority shareholding. There is nothing in this case in my view which can displace the general rule.
52. What if I am wrong and the general rule is as stated in <u>Irvine v. Irvine (No 2)</u> [2007] 1 BCLC 445, i.e. that there should be a discount unless Mr. Murrell was a quasi-partner in a quasi-partnership? On my above findings of fact, the

Company was a quasi-partnership but Mr. Murrell was a "sleeping" as opposed to a "quasi" partner. He was not a quasi-partner because he was not a director and had no right, legal or equitable, to be a director or to be otherwise involved in its management: insofar as his rights were concerned as a participant in the running of the business, in my view they were set out in his service contract, i.e. he was an employee whose employment was liable to termination without cause and without any obligations of good faith being owed to him at the end of the 6 month probationary period, which is what happened. However, he was in my view a sleeping partner in the sense that he had invested a substantial sum of money on the basis of a relationship of trust and confidence, which meant that the directors owed him a duty of good faith in their determination of their own salaries and the proper level of dividends. I have not needed to consider whether they acted in breach of that duty of good faith, because I have found that they acted in breach of their fiduciary duties as directors to the Company.

53. It has also been established that they unfairly prejudiced Mr. Murrell in the circumstances summarised in paragraph 13 above.

54. Mr. Mallin took a pleading point that it was not open to Mr. Murrell to contend for anything short of an actual agreement between the parties in relation to nominal directors' salaries and the payment of dividends because that is the averment in paragraph 9 of the Petition. I note there is no averment of a quasi-partnership in the Petition, but Mr. Mallin did not challenge the averment of a quasi-partnership in paragraphs 9.2 et seq. of the Joint Experts' Statement. In my view it is open to Mr. Murrell to contend for and to me to find an arrangement between the parties short of an actual agreement, namely an understanding giving rise to a duty on the part of Mr. Sanders and Mr. Swallow to act in good faith towards Mr. Murrell in this respect, and on this basis to find that Mr. Murrell was a sleeping partner in a quasi-partnership.

55. Further, there is little doubt that, were it not for the share purchase order available under the unfair prejudice remedy, Mr. Murrell would be entitled to a winding up order. Mr. Mallin submitted that Mr. Murrell had elected to remain an investor following his dismissal in 2002 and therefore, applying the <u>Harries</u> case, he should not be treated as entitled to a winding up order and his shares should be valued on a discounted basis. I reject that submission. Mr. Murrell did not elect to remain a shareholder following his dismissal, because the dismissal did not give him any ground for complaint. He was only a sleeping partner and remained such a partner notwithstanding his dismissal as an employee. Once it became apparent to him that he did have grounds for complaint as a result of the payment of excessive remuneration and inadequate dividends, he cannot in my view be said to have waived these grounds or otherwise elected to remain a shareholder.

56. In his closing submissions, Mr. Mallin came close to arguing that I had to take into account the fact that the Company had ceased trading in May 2009 and therefore there was no question of Mr. Sanders or Mr. Swallow being unjustly enriched by a sale of Mr. Murrell's shares at a discount. I reject any such argument. The whole purpose of the adoption of the valuation date of November 2006 was to avoid any inquiry as to why the Company had ceased to trade in May 2009. In my view, it is wrong to take into account events which

occurred after the valuation date and which cast no light whatsoever on the circumstances prevailing at that date.

57. In all the circumstances mentioned in the preceding paragraphs, even if the general rule were as set out in Irvine v. Irvine (No 2) [2007] 1 BCLC 445, in my view it would still be inappropriate to apply a discount because of the special circumstances of this case.

Valuation generally

58. Mr. Murrell adduced evidence from Mr. Faull of Hilton Sharp & Clarke Forensic Accountants. In his first report, he used the common methodology of valuing the Company as a whole (the capitalised earnings methodology), by assessing its maintainable profits before tax and directors' emoluments ("PBTBDE"), deducting from that what he considered to be a commercial level of remuneration for Mr. Sanders and Mr. Swallow, then deducting tax (i.e. employers' NIC on their remuneration and Corporation Tax), and then applying a price earnings multiplier taken from comparable quoted companies and applying a discount for non-marketability based on the BDO Private Company Price Index ("PCPI"). He calculated PBTBDE at £1,554,913 – this was agreed.

59. On each of the two controversial elements in his valuation, he used the following figures:

(i) Commercial level of remuneration = £228,000
(ii) Multiplier = 18

On this basis he valued the Company as a whole at about £16.5 million, of which 3% is about £495,000.

60. Mr. Sanders and Mr. Swallow adduced evidence from Mr. Cottle of BDO LLP. He used both Mr. Faull's capitalised earnings methodology and also a quite different methodology based on the dividend-earning potential specifically of Mr. Murrell's 3% shareholding, namely the dividend yield methodology. He much preferred the latter methodology in this case, for two principal reasons: first, this was the way in which minority shares, i.e. in quoted companies, are valued in the real world, and secondly because it was to be expected that the Company would distribute by way of dividend most of its profits, having no need to retain a significant proportion for working capital, investment or other purposes. He stated that businesses such as the Company, due to low barriers to entry, tended "to make hay when the sun shines" and therefore to distribute dividends as and when profits were generated. Mr. Faull did not disagree with this, but he adopted the dogmatic attitude that the dividend yield basis was not appropriate in this case. On the basis that no discount for a minority shareholding was appropriate in this case, as I have found, Mr. Mallin in his closing submissions came close to agreeing with Mr. Faull on this point, since Mr. Cottle accepted that a discount for a minority shareholding was inherent in his dividend yield methodology. In other words, Mr. Cottle in cross-examination, and Mr. Mallin in

his closing submissions, came close to accepting that there should be no additional discount for a minority shareholding in his dividend yield methodology.

61. So, I approach the matter on the basis that the appropriate methodology is that adopted by Mr. Faull. There may be other reasons for not using the dividend yield methodology, an issue I shall return to. But I will also consider Mr. Cottle's dividend yield methodology as a useful comparator.

62. On the capitalised earnings methodology, Mr. Cottle arrived at the following figures for the two controversial elements in Mr. Faull's valuation:

    (i) Commercial level of remuneration = £765,000
    (ii) Multiplier = 11.3

    On this basis he valued the Company as a whole at about £5.94 million, of which 3% is about £178,000. In other words, he valued the Company as a whole at about a third of Mr. Faull's figure.

63. On his dividend yield methodology, Mr. Cottle valued Mr. Murrell's 3% shareholding at about £120,000. The critical and controversial elements in this calculation were, apart from a commercial level of remuneration for Mr. Sanders and Mr. Swallow:
    (i) An applied dividend pay-out rate of 70% of profits.
    (ii) An applied dividend yield of 10% (i.e. x10), reached from the starting point of 5.1% (i.e. x20) from listed comparables and effectively halved to take into account the additional risk factors which Mr. Cottle lists at paragraphs 7.5 to 7.10 of his first report assuming minimal dividend headroom on the basis that the directors' remuneration is assumed to be of the order assessed by Mr. Cottle (i.e. £765,000): this crucial component of Mr. Cottle's calculation is explained at length, and I may say lucidly, at paragraphs 7.4 to 7.21 of Mr. Cottle's 1st report.

64. I begin with the commercial level of remuneration for Mr. Sanders and Mr. Swallow. I was not impressed by Mr. Cottle's approach. His starting point was the earnings of Mr. Sanders and Mr. Swallow at Everetts, adjusted for average pay increases over the period. In my view, their historic earnings when performing functions probably quite different to those they performed 6 years later in the Company are irrelevant. By November 2006, the Company's business had matured greatly. It had the 5 senior and highly-paid commission-only traders listed in paragraph 95 of Mr. Swallow's statement. It was possible for Mr. Sanders to step back from full-time work for family reasons. It is likely in my view that Mr. Swallow's functions were even more of a managerial nature by this time than they had been at the outset. Mr. Cottle justified his figures by reference to comparable figures from recruitment agents, but I was also not impressed with the reliability of these figures or the comparability of the jobs and positions to which they refer. In contrast, I was impressed by Mr. Faull's approach, namely the consideration of comparables in quoted companies. In my view, the starting point in a case such as this must be these comparables. There is, I recognise, some force in the criticisms made of Mr. Faull's use of the

comparables evidence. I think that he should have taken more account of the similar-sized stockbroking comparables, i.e. Fiske and Jarvis Securities, whose top executives I expect could command more than directors of a business such as the Company in November 2006. Instead Mr. Faull relied on London Capital Group, which, on the face of its published accounts, even though it conducted a broking business like the Company, was probably mainly involved in CFD trading as one of the leading market-makers. And I also agree with Mr. Mallin's submission that it is not right in this context to take into account the earnings of Mr. Sanders and Mr. Swallow qua owners from dividends. I think some guidance may also be derived from the estimated total sales commission earned by the 5 senior staff members listed in paragraph 95 of Mr. Swallow's 1st witness statement, which Mr. Faull calculated at about £125,000 pa each in the tax year April 2006 to March 2007. Doing the best I can from the information before me, and this is not a scientific process, I would increase Mr. Faull's figure of £228,000 for a commercial level of remuneration for the services of Mr. Sanders and Mr. Swallow as at 1st November 2006 to a figure representing 10% of the turnover of the Company, making it of the order of £312,000 for the year ending 30 September 2006. I derive some support for this conclusion from the following factors:

(1) In the year ended 30 September 2003, when they proceeded on the basis that they were 100% owners of the Company, they paid themselves about 10% of the turnover for that year.
(2) Even Mr. Cottle thought it right to express a commercial level of remuneration as a percentage of turnover. In my view, this reflected the business model of the Company, namely payment solely by reference to profits.

65. I turn now to the appropriate multiplier. In this context I prefer the evidence of Mr. Cottle. I was not impressed by Mr. Faull's reliance on LCG, which gave him as a starting point a multiple of 21.22, to which he applied a discount of 15%, little more than the 14% discount required by the PCPI. In my view, LCG was a far more secure business than the Company, in terms of all the risk factors identified by Mr. Cottle, and had greater growth prospects. I do not see any reason to depart significantly from the analysis of Mr. Cottle and I therefore find that the appropriate multiplier is 12, i.e. Mr. Cottle's 11.3 rounded up to the nearest whole number.

66. By my calculation, following Mr. Faull's at Bundle D page 214, applying the capitalised earnings methodology, the value of Mr. Murrell's 3% shareholding is a little over £300,000, which I would round down to that figure. The parties will no doubt check my arithmetic.

67. I note that, on Mr. Cottle's dividend yield methodology, if one assumes a commercial level for the directors' remuneration of 10% of turnover, and an assumed dividend pay-out ratio of 90%, but otherwise applies Mr. Cottle's dividend yield requirement of 10%, one arrives at a value for Mr. Murrell's shares of about £230,000. But I note that the yield requirement of 10% must be questionable, given that there was far more headroom for dividends than Mr. Cottle had allowed for, when I assess a reasonable level of commercial remuneration for the directors at £312,000, not £765,000 as assumed by Mr.

Cottle. Indeed, an additional reason why I am doubtful about the usefulness of this methodology in cases such as the present is the lack of verifiable objective evidence which underpins this crucial element, or more precisely how Mr. Cottle gets from his 5.1% to his 10%. It is common ground that this methodology becomes even less appropriate the more factors there are in a case which justified the retention of profits.

68. Taking all matters in the round, in my view the fair value of Mr. Murrell's 3% shareholding as at 1st November 2006 was £300,000 and I so declare.
69. So far as interest on that purchase price is concerned, these proceedings were held up for about 18 months because of the criminal charges against Mr. Sanders and Mr. Swallow. That feature of this case provides a powerful reason to award interest. I will award Mr. Murrell interest at the standard commercial rate on the purchase price for a period of 18 months to the date of this Judgment. Otherwise, I see no sufficiently powerful reason to award Mr. Murrell any interest having regard to the principles set out in Profinance v. Gladstone [2002] 1 WLR 1024, but I am prepared to review this issue when handing down this Judgment. Mr. Mallin submitted that I should not award any interest since his clients had accepted the date of valuation before any claim for interest was pleaded. I do not see that as a reason in itself for awarding no interest, since his clients did not stipulate at the time of their agreement to the date of valuation that it was on the basis that no interest would be awarded. Permission has since been granted to amend the Petition so as to claim interest.

The appropriate compensation for remuneration wrongly paid to the directors

70. I have found that for each of the financial years from that commencing 1 October 2003 Mr. Sanders and Mr. Swallow acted in breach of their fiduciary duties as directors in determining the levels of their remuneration. In my view, it is clearly wrong in principle that Mr. Murrell should receive any compensation for this after the valuation date of 1st November 2006. As for the 3 financial years ending 30 September 2004, 2005 and 2006, in my view Mr. Murrell is entitled to be compensated for the prejudice he has suffered as a result of the payment of directors' remuneration in excess of a fair commercial level of remuneration. That requires in my view the following calculation to be made:
    (1) Assume that directors' remuneration, including pension contributions, equalled 10% of turnover for the year in question, i.e. what I consider to be a fair commercial level of remuneration.
    (2) Calculate what additional dividends would have been declared in these years which would have left the same amounts by way of retained (i.e. undistributed) profits shown for each of these years. In other words, the amount of the excessive remuneration, plus whatever is saved in tax by assuming lower directors' remuneration, is assumed to have been distributed as dividends.
    (3) Mr. Murrell is assumed to have received 3% of those additional dividends.
71. I would not award Mr. Murrell any interest on this compensation. In my view there may well be an element of rough justice in Mr. Murrell's favour in treating

a commercial level of remuneration as 10% of turnover in the earlier two financial years, so I would allow for this by awarding no interest.

72. I leave it to the parties to agree a figure for compensation under this head.