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30 Paragraphs

THOMAS v UTS RAIL PTY LTD - BC201605848

Supreme Court of New South Wales -- Equity
Pembroke J

2015/179928

14-17 June, 14 July 2016

Thomas v UTS Rail Pty Ltd [**2016] NSWSC 991**

CONTRACT -- Expert determination clause -- Construction -- Process to be applied by parties to appoint an expert to determine fair value of shareholding.

CONTRACT -- Expert determination clause -- Construction -- Whether the person engaged by company for the purpose of seeking to reach agreement with shareholder can also be appointed as the 'expert' to determine the fair value of the shareholding.

CONTRACT -- Construction -- Meaning and effect of clause providing for successive mechanisms for determining 'fair value'.

Beevers v Port Phillip Sea Pilots Pty Ltd [2007] VSC 556; *500 Burwood Highway v Australian Unity* [2012] VSC 596; *Macro v Thompson (No 3)*[1997] 2 BCLC 36, cited

Pembroke J.

Introduction

[1] This is a challenge to an expert determination. The question in issue is primarily one of construction. Its nature is evident from the following statements made by me during counsels' addresses:

> No, it all depends upon the terms of the particular contract, and the problem that I see is that the structure is, first of all, that the parties have to exhaust their rights of negotiation. When they have exhausted their rights of negotiation, there is then a two-stage process or possibly a two-stage process. One is a nomination by the board, but if it fails to do so within 60 days the appointment will be made by the President of the Institute of Chartered Accountants.
>
> One would readily imply that the appointment by the President of the Institute would be of a person who was independent. And if you are going to suggest the appointment by the Board need not be independent, then there is a real tension there between those two limbs of clause 2(b) in the schedule.

[2] I also made the following observation:

> The question is at a higher level and that is whether as a matter of construction of the contract the parties should be taken to have contemplated that the President or the Board could have nominated someone who was not independent, at least in the limited sense of not having been involved in the negotiation process.

[3] And further:

> The contract in this case provides for a sequence of events which presupposes that before we get to the appointment of an expert by the Board or by the President of the Institute there has been an absence of agreement in the adversarial process of negotiation and agreement. So we have had a failure of one process and the contract then contemplates resort to another process. And surely that other process requires, as Vickery J said in *500 Burwood Highway v Australian Unity* [2012] VSC 596, that it be designed to bring about a result in which the parties could place their unreserved trust and confidence.

[4] Perhaps partly as a result of those observations senior counsel for the defendant requested that I defer commencing the writing of a judgment for 21 days 'in order to perhaps investigate and advance another course of determination of this dispute'. Unfortunately, the 21 days have elapsed and no result has ensued. What follows are the reasons that I deferred giving at the conclusion of the hearing.

The Facts

[5] On 13 August 2004, UTS Rail (the first defendant) was incorporated and has at all times carried on the business of railways signalling contracting in New South Wales. Relevantly, there were eight shareholders, each of whom held 12.5 percent of the ordinary shares in the company. Each of those eight individual shareholders owned or controlled a related corporate entity which held E Class shares. Seven of those eight entities held 13.5 percent of the issued E Class shares and one held 5.4 percent.

[6] On 18 March 2011, the parties entered into a put and call option deed. Its purpose was to put in place a mechanism by which a shareholder in UTS Rail could require his shares in the company to be acquired by the remaining shareholders. The relevant terms of the option deed are as follows:

> Schedule A
>
> ...
>
> 2. Purchase Price
>
> The fair value of the shareholding shall be determined as follows:--
> (a) by agreement between the parties; or
> (b) in the *absence of agreement* by the *appointment of an expert nominated by the Board of the Company*by ordinary resolution to determine the fair value of the shareholding. If an expert has not been nominated by the board within 20 business days of one party notifying the other in writing that they cannot agree on the fair value the secretary of the Company must request the nomination of an expert by the President of the Institute of Chartered Accountants (NSW Division) within 14 business days of the notice date and his decision will be final and binding on the parties.
> (i) The fair value of the shares will be the value determined by the expert.
> (ii) The fair value of the shares will be determined as at the date on which the option event takes place and the expert must determine the fair value of the relevant shares within 60 business days of the date of his appointment and must provide a copy of his valuation to each party.
> (iii) The expert so appointed may appoint a recognised experienced and qualified valuer to

> determine the value of any particular asset of the Company.
>
> (c) Matters to which the expert shall have regard
>
> Where an expert is appointed as aforesaid the expert:
> (i) in making his determination will value the business as a going concern excluding any good-will attached thereto.
> (ii) will have regard to the following matters (in addition to any other factors which he believes should properly be taking into account) based on the best information available at the time:
> (1) the prospects of the business (including, without limitation, taking into account the continuing association or involvement of any of the principals with the Company and its subsidiaries);
> (2) the value at a specified capitalisation rate appropriate to the business, of the estimated future maintainable earnings of the Company;
> (3) the yield which an open-market investor would reasonably require in an acquisition of the shares;
> (4) the net tangible assets of the Company *as disclosed in the accounts for the last preceding financial year* or, if no accounts for the Company are available, as disclosed in the latest management accounts of the Company;
>
> (iii) in making his determination will act as an expert and not as an arbitrator; and
> (iv) his determination will be final and binding upon the Company and the parties to this Deed.

[7] Until 13 August 2014 when the first and second plaintiffs resigned their directorships, all of the individual shareholders were directors of the UTS Rail. On that date UTS Rail received resignation notices from the first and second plaintiffs and an option notice in accordance with the option deed.

[8] On 22 September the solicitors for UTS Rail briefed Mr Shields to undertake a valuation of the shares in the company as at 30 June 2014. The intended purpose of this valuation was to assist UTS Rail in attempting to seek agreement on the fair value of the shareholding pursuant to clause 2(a) of Schedule A of the option deed. Mr Shields provided to UTS Rail his valuation on 6 November. It valued UTS Rail at $3,977,773 at 30 June. It valued the ordinary shares at $11 and the E Class shares at $10.75 each.

[9] UTS Rail provided the valuation to the plaintiffs in an endeavour to induce them to agree with it. They were not happy with it however and procured their own valuation from an expert accountant and valuer, Mr Greenwood. The plaintiffs provided Mr Greenwood's valuation to UTS Rail on 10 December. The parties did not agree on a figure for fair value. Mr Shields and Mr Greenwood were the parties' representatives in the battle over the 'agreed' fair value.

[10] On 20 January 2015 the plaintiffs wrote to UTS Rail and said:

> We now hereby give notice to your clients that they cannot agree on the fair value of their respective shareholding.

[11] On 27 January UTS Rail commenced the process contemplated by clause 2(b) of Schedule A. The board resolved that Mr Shields' firm 'be appointed as the expert to determine the fair value of UTS Rail Pty Ltd as required by the put and call option deed (reference appendix A Section 2)'. On 30 January it informed the plaintiffs that it had so resolved.

[12] On 2 March UTS Rail instructed Mr Shields to carry out 'the valuation'. Mr Shields provided his valuation on 8 April 2015. It valued UTS Rail entirely at $4,239,097 as at 13 August 2014. It valued the ordinary shares at $11 and the E Class shares at $11.46 each. On 14 April, Mr Shields' second valuation was provided to the plaintiffs and the

defendants.

Defendants' submissions

[13] The defendants' written submissions implicitly acknowledged that in the events that had occurred, Mr Shields was not 'independent' of UTS Rail in the sense only that he had been retained by and advised UTS Rail at the stage in the process contemplated by clause 2(a) of Schedule A to the option deed. The substance of the defendants' submissions was that there was no requirement in clause 2(b) for independence, either as a matter of necessary implication or construction.

[14] They contended that clause 2(b) 'does not mandate the appointment of an independent expert but merely an expert'; that it was 'significant that the parties did not choose to describe the expert as an independent expert in the deed'; and that 'the absence of the word 'independent' from the option deed means that the expert can have an association with UTS Rail'.

[15] In a sense, the issue is not strictly one of 'independence'. The use of that term is a distraction. The real issue of construction is whether, by the language which they used in schedule A of the option deed, the parties should be taken to have intended that the same valuer that UTS Rail retained, engaged and paid to advance its cause in the process contemplated by clause 2(a) of Schedule A, could subsequently be appointed by the Board of UTS Rail for the different purpose required by paragraph (b) of the same clause.

Paragraph (a)

[16] The work contemplated by each of paragraphs (a) and (b) is conceptually different. The successful end result of the process envisaged by paragraph (a) is an agreement between the parties. In order to arrive at an agreement, each party would be entitled to advance its own case for a higher or lower valuation. The case so advanced could reflect their rival commercial imperatives, their differing advice and their competing objectives. And the process contemplated does not necessarily mean that the agreed value is in fact the fair value. It is simply the agreed fair value.

[17] An agreement may eventuate because one party has overborne the other; because one party does not have the resources, the time or the interest to challenge the valuation amount proposed by the other; or because one party's bargaining tactics are superior to those of the other. Moderation, reasonableness and collaboration are not necessarily required. An agreement could be reached because the stronger party adopts an inflexible position and is not prepared to compromise and the weaker party is unwilling to delay a resolution or to pay the costs involved in triggering the expert determination process.

[18] The process of reaching agreement contemplated by paragraph (a) permits an antagonistic and adversarial approach by each party with the object of seeking to persuade the other to accept its contended amount. It also recognises that an agreement may not eventuate.

Paragraph (b)

[19] In the event of a failure to reach agreement, a different process is triggered. Paragraph (b) contemplates a process that involves an expert being appointed. The expert may be appointed by the Board of the company or by the President of the Institute of Chartered Accountants, if the Board delays for the specified period in nominating someone.

[20] The appointment pursuant to paragraph (b) is designed to resolve a disagreement between the parties. Its function is to arrive at an amount for fair value independently of their attempts to reach agreement. The amount so arrived at may be the same as that proposed by the shareholder, or the same as that proposed by the company, or a different amount altogether. The expert serves the interests of both parties but is not beholden to either of them. And paragraph (d) re-enforces the different nature of the task by providing that the expert's costs of determining the fair value will be paid equally by both parties.

[21] In this context, I have no real difficulty in attributing to the parties an objective intention that the expert to be appointed pursuant to paragraph (b), whether by the company or by the President of the Institute, could not be the same person who was engaged and paid for by the company for the purposes of paragraph (a).

[22] Having exhausted their attempts to agree on fair value pursuant to paragraph (a), the second stage contemplated by paragraph (b) involves a process by which the parties committed themselves, in a real and practical sense, 'to entrust the determination [of value] to a [process] in which they could place their unreserved trust and confidence': *500 BurwoodHighway Pty Ltd v Australian Unity Ltd* [2012] VSC 596 at [134]. That objective would not be served if the appointed expert were the person used by the company to advocate its position pursuant to the earlier adversarial process.

[23] In my view, the objective intention of the parties, in the known context and having regard to the obvious commercial object and purpose of Schedule A of the option deed, would not have countenanced the appointment of an expert such as Mr Shields in these circumstances. The fact that his costs were to be paid equally by both parties re-enforces that likelihood. Properly construed, paragraph (b) excludes that possibility.

[24] In a different situation whether the parties have simply agreed to the appointment of an expert to determine the value of one party's shareholding and have not stated that the valuer should be independent, I see no difficulty in general terms in the appointment of a valuer or accountant with a long-standing association with the company. That is the point that Robert Walker J (as Lord Walker then was) made in *Macro v Thompson (No 3)*[1997] 2 BCLC 36 at 65. The reasoning put forward tentatively by Dodds-Streeton J in *Beevers v Port Phillip Sea Pilots Pty Ltd* [2007] VSC 556 at [300] in relation to the notion of 'apprehended bias' in this area of the law, is in my view, not convincing, but in any event it is not appropriate for me to apply in this case and not necessary for me to decide.

[25] What makes the difference in this case is the scheme of successive processes contemplated by paragraphs (a) and (b) and the different nature of each of those processes. They provide the key that unlocks the answer to the question of construction.

Misconception of function

[26] Finally, there is another ground on which the plaintiffs are entitled to succeed. Mr Shields, whose honesty, integrity and valuation expertise were not in the least in issue, does appear to have misconceived his function. The fault may well lie with those instructing him. But the result was that he approached the solemn task of performing the expert determination task pursuant to paragraph (b) by thinking that he was doing no more than updating the valuation he had provided to UTS pursuant to paragraph (a).

[27] The following evidence explains the problem: Mr Shields said:

> I considered that the 8 April report was a continuation of my original engagement.

[28] There was then the following exchange:

> Q. You will see in paragraph (b) there is provision that in the absence of agreement for appointment of an expert nominated by the Board of the Company and by ordinary resolution to determine the fair value of the shareholding I wanted to ask you in conducting the November 2014 valuation was it your understanding that you were the expert carrying out that task?
>
> A. Yes.

HIS HONOUR:

Q. Mr Shields, how could that be? There was no resolution of the Board at UTS until the following year?

A. At that time my instructions were from the solicitor that I was to be conducting the valuation...it was my understanding that that was my role.

Q. Then what did you think you were doing in the following April?

A. I -- I thought I was updating the report to the relevant date based on the later information.

Orders

[29] For those reasons, there should be declarations and orders that reflect the fact that the appointment of Mr Shields as the expert pursuant to paragraph 2(b) of schedule A to the option deed was invalid and that his valuation dated 8 April 2015 was void and not in accordance with the requirements of the contract.

[30] The defendants should pay the plaintiffs' costs.

Order

See paragraphs [29] and [30].

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Counsel for the defendants: *M J Windsor SC* with *M J Bennett*

Solicitors for the plaintiffs: *McIntosh McPhillamy & Co*

Solicitors for the defendants: *King Cain Solicitors*