Supreme Court of New South Wales

Geoffrey Alan Holt and Anor v Robert Hedley Cox [1997] NSWSC 144 (18 April 1997)

Geoffrey Alan HOLT & Anor v Robert Hedley COX

40010/95, ED 3378/91

Friday 18 April 1997

THE SUPREME COURT OF NEW SOUTH WALES COURT OF APPEAL

MASON P, PRIESTLEY JA, COLE JA

CATCHWORDS: Companies - Shares - valuation by auditor - appropriate method - whether in accordance with contract embodied in Articles - whether "a fair price"

EX TEMPORE/RESERVED: RESERVED

ALLOWED/DISMISSED: DISMISSED (by majority)

Companies - dispute concerning valuation of shares of departing director (respondent) - shares issued to respondent pursuant to Special Resolution - on departing company respondent refuses to transfer shares to remaining directors (appellants) at value determined by auditor - appellants as controlling shareholders bring proceedings in Supreme Court seeking declaration that auditor had duly determined a fair price for shares and seeking specific performance requiring the respondent to transfer the shares - appeal against Santow J's finding that valuation not in accordance with contract.

Held; appeal dismissed, (Mason P and Priestley JA, Cole JA dissenting):

(i) The auditor erred in his handling of the issue of winding up which prevented the ensuing determination of the value of the shares from being the "fair price" required by the Special Resolution.

Observations, on the review by courts of valuation determinations by experts.

Legal & General Life of Australia Ltd v A Hudson Pty Ltd (1985) 1 NSWLR 314; ***Abrahams v Federal Commissioner of Taxation*** [1944] HCA 32; (1944) 70 CLR 23; ***Jones v Sherwood Services Plc*** [1992] 1 WLR 277; **applied**.

Gambotto v WCP Ltd [1995] HCA 12; (1995) 182 CLR 432; ***Strang Patrick Stevedoring Pty Ltd v James Patrick & Co Pty Ltd*** (1993) 32 NSWLR 583; ***McCathie v Federal Commissioner of Taxation*** [1944] HCA 9; (1944) 69 CLR 1; **referred to**.

JUDGMENT

MASON P: The issues in this appeal are:

(a) whether the determination by the auditor of a company of "a fair price" at which a parcel of shares should be offered by a departing shareholder to the existing shareholders was made in accordance with the contract embodied in the Articles of Association; and

(b) whether specific performance should be ordered of a pre-emption agreement embodied in that contract.

Santow J declared that the auditor's valuation was not in accordance with that contract. Accordingly, he did not have to address the second issue.

FACTS

F B Leonard Advertising Pty Limited ("the company") conducted a long established advertising business. At all material times its controlling shareholders were Mr and Mrs Holt. Each was a director of the company, Mr Holt being its chief executive.

On 26 May 1987 Mr Holt engaged Mr Cox as a consultant. Initially the engagement was on a trial basis without remuneration. By 1 August 1987 Mr Cox was receiving remuneration of $5000 per month plus car plus expenses. By late November 1987 Mr Holt was looking at options whereby Mr Cox might be given an incentive to stay with the company. There were discussions spanning several months. The upshot was an issue of five "A" class shares to Mr Cox which, together with a continuing remuneration "package" of $120,000 per annum, were intended to represent a stake in the company designed to give him an incentive to remain and to develop the company.

The rights attaching to these shares are set out in a Special Resolution. It appears that a share certificate was handed to Mr Cox on 1 July 1988 and that he became a director in the company on that day. However, the Special Resolution setting out the rights attached to those shares was passed on 13 October 1989. It is in the following terms:

"That the authorised capital of the company shall forthwith be divided into 49990 Ordinary shares at $2 each, 5 "A" class shares of $2 each and 50000 5% Redeemable Preference shares of $2 each. The rights, duties and restrictions already attaching to the Ordinary and 5% Preference shares shall continue to apply.

The rights, duties and restrictions attaching to the "A" class shares shall be as follows:-

(a) The right to appoint a director.

(b) The right to receive such dividends as may be declared by the Directors from time to time.

(c) The right on winding up to receive in total twenty percent (20%) of any distribution of capital.

(d) The shares may only be held by Robert Cox or by an entity which Robert Cox is the beneficial owner and may only be held by Robert Cox or his entity while he is employed by the company, a subsidiary of the company or by an associated company. Upon termination of the employment of Robert Cox the shares must be offered to the holders of the Ordinary shares in the same proportion as their existing shareholding at a fair price determined by the auditor of the company.

(e) Should Robert Cox be dismissed from the employment of the company, a subsidiary of the company or associated company for wilful misconduct then the "A" class shares shall be surrendered to the holders of the Ordinary class shares in the same proportion as their holding in the Ordinary class shares without consideration."

In consequence of earlier allotments of shares and allotments consequent upon the said special resolution, the shareholding in the company has at all material times been as follows:

(a) Geoffrey Holt: 23,900 ordinary shares

25,000 redeemable preference shares

30,000 "B" class redeemable preference shares

(b) Valerie Holt: 10,000 ordinary shares

10,000 redeemable preference shares

25,000 "B" class redeemable preference

shares

(c) Robert Cox: 5 "A" class shares

Mr Cox was dismissed on 13 November 1990. (This was not for "wilful misconduct", so para (e) of the Special Resolution has no application.) He resigned as a director on that or the following day. On 28 November 1990 he formally requested that the value of his shareholding be determined by the auditor in accordance with clause (d) of the Special Resolution.

On 4 June 1991 the company auditor, Mr Adam, valued Mr Cox's 5 "A" class shares at $171. Mr Cox thereupon refused to transfer his shares at the value determined by the auditor. In consequence, proceedings were commenced by Mr and Mrs Holt in 1991 seeking a declaration that the auditor had duly determined a fair price for Mr Cox's shares, and orders in the nature of specific performance requiring Mr Cox to transfer the shares at the price determined by the auditor. In his defence, Mr Cox disputed the validity of the determination by the auditor. He did not plead any equitable defences. As already indicated, Santow J ruled that the valuation was not in accordance with the contract.

The events leading to up to the valuation were as follows:-

(a) On 10 April 1991 the company requested the auditor to determine the fair price of the Cox shares. The request was accompanied by copies of a letter of advice from Phillips Fox, the solicitors for Mr and Mrs Holt and an Opinion of Mr Hely QC.

(b) These documents were disclosed to Mr Cox and his solicitors.

(c) Mr Cox sent submissions from his solicitors to the auditor.

(d) The auditor commissioned and received advice from Mr Wayne Lonergan of Coopers & Lybrand.

THE AUDITOR'S VALUATION

Mr Adams provided his valuation in a report which exposed his reasoning processes.

The auditor referred to the issued share capital and the rights conferred upon each class of shareholder. He summarised the assets and liabilities and the trading results of the company for the four years ended June 1990. It was noted that unaudited management assets indicated that the operating result for 1991 was expected to be in a break even position.

The report discussed the methodology for valuation, and indicated an awareness of the choice between alternative methods. "The most appropriate method for a particular valuation will depend upon many factors, including the size of the parcel, the special characteristics and nature of the shares being valued." It was stated that, "under normal circumstances" the valuation of a share would be based upon the present value of the cash anticipated to flow to the owners of that share. "In the case of a minority shareholding in a private company, such shares are normally valued on the basis of the capitalisation of future maintainable dividends. A minority shareholder usually has no control over the underlying cash flow or assets of the company, nor does the shareholder have control over the timing, direction or quantum of reinvestment of the earnings of the company. The shareholder is reliant on the return from the investment being distributions made by the company from time to time, which are in turn dependent upon the distribution policy of the company which is normally dictated by the controlling shareholder."

It was recognised that there was a "third valuation basis [which] is that which calculates the amount that would be distributable to shareholders assuming an orderly realisation of the company's assets. This

method is appropriate if a company is likely to be wound up or if the shares being valued have the power to bring about the liquidation of the company". The auditor cited a statement by Gibbs J in ***Gregory v Federal Commissioner of Taxation*** [1971] HCA 2; (1971) 123 CLR 547 at 565 (quoting from ***Commissioner of Succession Duties (SA) v Executor Trustee and Agency Co of South Australia Ltd*** [1947] HCA 10; (1947) 74 CLR 358 at 362) that "a prudent purchaser does not buy shares in a company which is a going concern with a view of winding it up, so that the more important item is the determination of the probable profit which the company may be reasonably expected to make in the future". He concluded that:

"The Shares represent a minority interest and therefore should be valued on the basis [sic] *capitalisation of future maintainable dividends."*

The auditor then proceeded to apply this valuation method. He had regard to the dividend rights of the Cox shares. Making various assumptions and adjustments he concluded that a willing but not anxious buyer of the shares would seek a dividend yield in the range of 5% and 6.5% per annum. The net profit after tax for the last four years was calculated and divided by four, so as to show an annual average ($66,907 per annum). The figure of $171 for the 5 "A" class shares was arrived at as follows:

"After taking into account factors referred to above, and based on a maintainable after tax profit of $66,907 per annum, we consider that a willing but not anxious seller would concede, that, even in the unlikely event that the company distributed 100% of its profits after tax, the fair market value of the Shares would not exceed the range of $131 and $171 as at 13 November, 1990 calculated as follows:

$ ***Upper $ Lower $***

Future maintainable

operating profit after tax 66,907

Less*: Dividend attributable*

to 5% preference share-

holders (9,000)

Future maintainable operating

profit attributable to Ordinary

and A Class Shares 57,907

Dividend per share (33,900

Ordinary Shares and 5 A

Class Shares) 1.71

Dividend yield 5% 6.5%

Value per share (assuming

100% dividend payout) $ 34.20 $26.31

Value per 5 A Class Shares $171.00 $131.55"

The manner in which the auditor discussed and dismissed the relevance of winding up (in paras (25)-(33) of his report) is critical to the appeal. I will set out those paragraphs later in the judgment.

MATTERS NOT IN ISSUE

There was an issue at trial as to whether Mr Holt had engaged in misleading or deceptive conduct in the course of negotiating the arrangements which were embodied in the special resolution and share allotment made to Mr Cox. The trial judge found that no misrepresentation had taken place, nor had there been any reliance upon it. These findings were not challenged in the appeal. Accordingly, the parties' rights with reference to the pre-emptive right to acquire the Cox shares are to be determined in accordance with the contract embodied in the Articles as amended by the special resolution.

There is no suggestion that Mr Adam failed to act honestly or impartially. Nor is it contended that there was any procedural miscarriage. It is also common ground that Mr Adam was acting as an expert rather than an arbitrator.

In consequence of these matters, it was also common ground that Mr Adams' valuation was binding upon the parties unless it could be demonstrated that the valuation was not made in accordance with the contract: see ***Legal and General Life of Australia Ltd v A Hudson Pty Ltd*** (1985) 1 NSWLR 314 at 335-6; ***Woolworths Ltd v Merost Pty Ltd*** (1988) 14 NSWLR 300 at 303. This meant that the ultimate issue was whether Mr Adam had valued Mr Cox's shareholding at "a fair price". Such a formula generally ensures that the methodology to be used is a matter for the judgment of the valuer. In that context, mistakes of methodology may be mistakes in the course of doing what the contract requires: see ***Strang Patrick Stevedoring Pty Ltd v James Patrick & Co Pty Ltd*** (1993) 32 NSWLR 583 at 592.

It was also common ground that a "fair" price was, in the words of the advice given by Mr Hely QC, to be "the real value of the shares to Cox. That effectively requires the auditor to assume that the "A" class shares are a marketable commodity and to disregard the provision in the Articles that Cox is the only eligible holder of them". See also ***McCathie v Federal Commissioner of Taxation*** [1944] HCA 9; (1944) 69 CLR 1 at 6; ***Re an Arbitation, Fletcher Humphreys & Co v Middleton*** [1944] NZLR 502 at 507.

SANTOW J'S JUDGMENT

The trial judge identified three broad errors by the auditor in complying with the contract:-

(a) The failure to take account of the prospect of future fructification of the winding up right;

(b) the failure to take account of the shared expectations of Mr Cox and Mr and Mrs Holt; and

(c) the failure to take account of Mr Cox's continued right to appoint a director and his potential capacity to frustrate a future share sale by reason of his interest in 20% of the capital on winding up.

As will become apparent, (a) and (b) are two sides of the same coin.

ISSUES IN THE APPEAL

The appellant's case in the appeal was that the auditor's report was not shown to embody any error that would take the determination as to the valuation of the Cox shares outside the contractual stipulation of being "a fair price determined by the auditor". It was contended that the auditor's reasons demonstrated no error; alternatively, no error that would invalidate the determination in accordance with the principles expounded by McHugh JA in ***Legal & General Life of Australia Ltd v A Hudson Pty Ltd*** (1985) 1 NSWLR 314 at 335-6.

The respondent supported the judgment below and submitted that the auditor's determination was flawed to such an extent that it did not represent "a fair price" as contemplated by the Special Resolution. Alternatively, it was argued that the Court should distinguish McHugh JA's judgment in ***Legal & General*** because there it was stipulated that the auditor's determination was to be "final and binding on the parties".

The respondent also argued that the determination might be valid at law yet vitiated by such error that the Court would decline to enforce it by decree of specific performance. (The distinction between the respective roles of equity and common law is discussed by McHugh JA in ***Legal & General*** (at 336).) In response, the appellant contended that it was not open to raise this matter, which had not been pleaded.

The appellant relied upon the principles embodied in three recent cases. In ***Legal & General*** (at 335-6) McHugh JA said:

"In my opinion the question whether a valuation is **binding** *upon the parties depends in the first instance upon the terms of the contract, express, or implied. This was pointed out by Sir David Cairns in the Court of Appeal in* ***Baber v Kenwood Manufacturing Co Ltd*** *(at 181). A valuation obtained by fraud or collusion can usually be disregarded even in an action at law. For in a case of fraud or collusion the correct conclusion to be drawn will almost certainly be that there has been no valuation in accordance with the terms of the contract. As Sir David Cairns pointed out, it is easy to imply a term that a valuation must be made honestly and impartially. It will be difficult, and usually impossible, however, to imply a term that a valuation can be set aside on the ground of the valuer's mistake or because the valuation is unreasonable. The terms of the contract usually provide, as the lease in the present case does, that the decision of the valuer is "final and binding on the parties". By referring the decision to a valuer, the parties agree to accept his honest and impartial decision as to the appropriate amount of the valuation. They rely on his skill and judgment and agree to be bound by his decision. It is now settled that an action for damages for negligence will lie against a valuer to whom the parties have referred the question of valuation if one of them suffers loss as the result of his negligent valuation:* ***Sutcliffe v Thackrah*** *[1974] AC 727;* ***Arenson v Arenson*** *[1977] AC 405. But as between the parties to the main agreement the valuation can stand even though it was made negligently. While mistake or error on the part of the valuer is not by itself sufficient to invalidate the decision or the certificate of valuation, nevertheless, the mistake may be of a kind which shows that the valuation is not in accordance with the contract. A mistake concerning the identity of the premises to be valued could seldom, if ever, comply with the terms of the agreement between the parties. But a valuation which is the result of the mistaken application of the principles of valuation may still be made in accordance with the terms of the agreement. In each case the critical question must always be: Was the valuation made in accordance with the terms of a contract? If it is, it is nothing to the point that the valuation may have proceeded on the basis of error or that it constitutes a gross over or under value. Nor is it relevant that the valuer has taken into consideration matters which he should not have taken into account. The question is not whether there is an error in the discretionary judgment of the valuer. It is whether the valuation complies with the terms of the contract ."*

McHugh JA was the only member of the Court who addressed these legal principles: the other two members (Mahoney and Priestley JJA) held that there was no error in the challenged valuation. The reasoning of McHugh JA has been followed with approval in New South Wales and elsewhere: see ***Woolworths Ltd v Merost Pty Ltd*** (1988) 14 NSWLR 300; ***Crusader Resources NL v Santos Ltd*** [1991] SASC 2915; (1991) 58 SASR 74; ***Ricciardello v Caltex Oil (Australia) Pty Ltd***, WA SC, Full Ct, unreported, 23 April 1991; ***J L Atkinson v Ebonstone*** Qld C of A, unreported, 3 March 1992; ***Strang Patrick Stevedoring Pty Ltd v James Patrick & Co Pty Ltd*** (1993) 32 NSWLR 583; ***Burdon Pty Ltd v Gillford Pty Ltd*** Fed Ct, Full Ct, unreported 21 December 1995. The parties did not challenge those principles, although the respondent sought to distinguish ***Legal and General*** on the basis that the Special Resolution did not declare that the determination was to be "final and binding on the parties".

In ***Email Ltd v Robert Bray (Langwarrin) Pty Ltd*** [1984] VicRp 2; [1984] VR 16 at 21 the Full Court of the Supreme Court of Victoria (Crockett, Kaye and Gray JJ) said:

"But, in this case, the parties provided that `such annual rental shall be as determined as a reasonable rental by a single certified valuer'. In our opinion, the parties have clearly bestowed upon the valuer the obligation of determining what circumstances are relevant to the question of fixing `a reasonable rental'. We do not consider that the Court should make a declaration which delineates the circumstances to which the valuer should have regard. The declaration that we are disposed to make is that `a reasonable rental' means a rental which the valuer considers is reasonable having regard to all the circumstances which the valuer considers are relevant."

In ***Jones v Sherwood Services Plc*** [1992] 1 WLR 277 at 284 Dillon LJ (with whom Balcombe LJ agreed) said:

"The starting point for the modern statement of the law is, in my judgment, the decision in ***Campbell v Edwards*** *[1976] 1 WLR 403 and in particular the passage in the judgment of Lord Denning MR, at p407:*

`It is simply the law of contract. If two persons agree that the price of property should be fixed by a valuer on whom they agree, and he gives that valuation honestly and in good faith, they are bound by it. Even if he made a mistake they are still bound by it. The reason is because they have agreed to be bound by it. If there were fraud or collusion, of course, it would be very different. Fraud or collusion unravels everything.'

That statement was, as a matter of principle and disregarding the earlier authorities, endorsed by Megaw LJ in ***Baber's*** *case [1978] 1 Lloyd's Rep 175, 179, and concurred in by the other members of this court in* ***Baber's*** *case. It is in line with the passage, cited by Sir David Cairns in* ***Baber's*** *case, at p181, from the judgment of Sir John Strange MR in* ***Belchier v Reynolds*** (1754) 3 Keny 87, 91:

`Whatever be the real value is not now to be considered, for the parties made Harris their judge on that point; they thought proper to confide in his judgment and skill and must abide by it, unless they could have made it plainly appear that he had been guilty of some gross, fraud or partiality'".

As McHugh JA develops in more detail in his judgment in ***Legal & General***, these and other recent authorities depart from earlier statements of the law in that they recognise it is insufficient for a dissatisfied party to point to some mistake in the reasoning process exposed by the expert valuer. At least as a matter of common law, a valuation will stand if it satisfies the description given in the contract between the parties. The readiness in the courts to provide greater latitude for experts to choose between different valuation methods and, within limits, to make errors in assessing facts or taking matters into consideration or declining to take matters into consideration, is influenced by the recognition in ***Arenson v Arenson*** [1977] AC 405 and ***Sutcliffe v Thackrah*** [1974] AC 727 that the expert who negligently determines a valuation will be held liable in damages to the party suffering loss in consequence of the expert's negligence.

As Mr Biscoe QC pointed out in argument, this recently-found duty of care of the expert does not fully explain why the courts have hardened in their attitude to reviewing valuation determinations. For one thing, the modern cases show that a certificate may be "valid" though it embodies some factual error without necessarily exposing the expert valuer to liability in negligence. It appears to me that the trend in recent years has also been influenced by a recognition that courts have no greater expertise than expert valuers; and that where parties have chosen voluntarily to commit the determination of valuation to an expert, judicial restraint is an appropriate response. Nevertheless, it is recognised that there are limits to the types of error which will be overlooked in the courts, even in the most robust statements of the modern position. As Sir Frederick Jordan once reminded us, "there are mistakes and mistakes" (***Ex parte Hebburn Ltd; Re Kearsley Shire Council*** [1947] NSWStRp 24; (1947) 47 SR(NSW) 416 at 420). Especially where, as here, the valuer exposes his or her reasoning process, then the ultimate issue for judicial determination remains that of deciding whether the valuation was in accordance with the parties' contract.

A close reading of McHugh JA's judgment in ***Legal & General*** indicates that his Honour was not propounding the view that a valuation will stand regardless of error. Rather he was making the point that mistake is not itself a ground of vitiation: see also ***Wamo Pty Ltd v Jewel Food Stores Pty Ltd*** (1983) ANZ Conv R 50. A valuation may contain factual error or embody consideration of matters which should not have been taken into account, but it does not follow that the result is outside that which the contract contemplated would be within the realm of determination by the valuer. As McHugh JA makes plain, "in each case the critical question must always be: Was the valuation made in accordance with the terms of [the] contract? **If it is**, it is nothing to the point that the valuation may have proceeded on the basis of error or that it constitutes a gross over or under value" (emphasis added). The statement in the next sentence ("Nor is it relevant that the valuer has taken into consideration matters which he should not have taken into account.") must be read in the same context. His Honour is not saying that these matters are never relevant. Rather he is saying that they are not relevant **if** the valuation was in accordance with the terms of the contract.

I have already mentioned Sir Frederick Jordan's apophthegm about "mistakes and mistakes". It was uttered in a mandamus case. It seems to me that administrative law provides a useful analogy in the present context. There, the decision maker has an area within which he or she may make mistakes, even mistakes of relevance or law, without failure to exercise the jurisdiction conferred, or exposing the

decision to quashing. It is only those mistakes which involve a failure to address something which the statute requires to be taken into account that will expose the decision to judicial review on jurisdictional grounds: ***Sean Investments Pty Ltd v MacKellar*** [1981] FCA 191; (1981) 38 ALR 363 at 385 (Deane J); ***Minister for Aboriginal Affairs v Peko-Wallsend Ltd*** [1986] HCA 40; (1986) 162 CLR 24 at 39. The criteria of discrimination between "mistakes and mistakes" are not determinable in advance: cf ***R v Australian Broadcasting Tribunal; Ex parte 2HD Pty Ltd*** [1979] HCA 62; (1979) 144 CLR 45 at 49.

DID THE AUDITOR FAIL TO HAVE REGARD TO ALL OF THE SHARES' "POSSIBILITIES"?

The respondent's principal complaint, and one which found favour with Santow J, was that the valuation exercise paid no regard to the prospect that the company would be wound up in the event that it could be built up and sold (probably to an overseas buyer). It was contended that this expectation was (in the respondent's written submission) "common, communicated and firm" and that it was essential to an understanding of the advantages and possibilities attached to the Cox shares. Santow J effectively accepted this argument. The evidentiary basis of the submission may be summarised as follows:

(a) On 24 November 1987 Mr Holt spoke to Mr Cox about the proposal to issue shares to him. According to Mr Holt's affidavit he said:

"I want to give you a carrot. The carrot is that we will build the company up and sell it to an overseas interest and on the day we sell it you will get 20% of the sale price, that's the carrot. So we would like you to become a shareholder."

(b) On a later occasion, when presenting Mr Cox with a copy of the draft Resolution, Mr Holt said: "We will issue the shares on the basis of the carrot and you will have a 20% of the sale price of the company when we sell it once we have built it up and sold it to an overseas interest."

(c) On other occasions Mr Holt stated his intention to wind-up the company upon its sale to an overseas interest.

(d) In his sworn evidence at the trial Mr Holt adhered to this position. He referred to Mr Cox as having been given "a long term carrot" (T p81). "I regarded him as a person with whom I could have a long term relationship, achieve a goal and share the rewards" (T p81). Elsewhere he described the arrangement as offering an incentive. "It was offered as a long term idea that he would get something at the end" (T p85). While he recognised that there was a possibility that there never would be a sale, Mr Holt adhered to his stated intention expressed to Mr Cox, that he "believed we could build up the agency and sell it. I don't want to be there for ever, and neither did he, and I just wanted up to do something together and at the end realize the value together. Not before, but at the end, and that was my purpose and it was a genuine purpose." (T p92) "The intention was ... to give Mr Cox a long term stake realised at the sale of the agency and not before" (T p91). (Mr Holt had been in the advertising industry for over 30 years, so it is feasible that he may have been giving some consideration to realising his and his wife's investment in the not too distant future.)

(e) Of course, any decision in relation to sale resided effectively with Mr and Mrs Holt, at least so long as the shareholding and directorships were as they stood consequential upon the share allotments referred to earlier. But Mr Holt was constant in his stated intention that, in the event of a sale, he and Mrs Holt would do their part to wind-up the company and thus bring about the event which would cause Mr Cox's 20% interest to "fall in". The following passage in Mr Holt's evidence (T pp93-4) was regarded as significant by Santow J:

"HIS HONOUR: Q. As I understand your evidence, your intention was to give Mr Cox, as you put it, a long term interest in the company in the event that the agency was sold?

A: Yes, sir.

Q: Assuming it were sold, how did you intend that he would receive the benefit of that interest?

A: To some degree I was reliant on my accountant, but I assumed that there would be money paid, whatever had to be paid out in regard to the sale would be paid out and then we would do - Mr Cox would get 20 percent and I would get 80 percent.

Q. By winding up the company?

A: Not necessarily. If it was not necessary to wind it up, we may have agreed, or we may have talked together and agreed on a 20/80 split. The company as a shelf company might have been useful because it was pre capital gains tax.

Q. So it might have been in what of the ways?

A. I would have consulted with my accountant but if it needed to be liquidated that is the way it would have gone.

Q. Supposing a sale were in contemplation, in a month or so hence, and you were to have terminated his employment, what was your intention then, as regards his rights to receive?

A. Can I clarify the question? Is it a month from now or a month after I fired him.

Q. I am simply putting aside when you in fact fired him and simply ask the question hypothetically.

A. Hypothetically if this was not resolved and somebody came to me today and bought the agency, he would get his 20 percent.

Q. Assuming he were fired - assume these facts, that you know a sale is about to take place, and that he was still in the employment of the company?

A. Yes.

Q. Would it have been your intention, looking at the time the resolution was first passed, and without the wisdom of hindsight, would it have been your intention that you would be free to terminate his employment just prior to sale?

A. Oh, Gosh, no, and I said to you if I sell today he gets 20 percent. I will honour that until the shareholding is decided otherwise."

(f) The genuineness of this position is underscored by the fact that the letter from Phillips Fox to Mr Holt which was placed before Mr Adams as part of his initial instructions included the following "*[Fact]":*

"4. At the time of agreeing to amend the Articles it was intended by you and your wife that the business of the Company would be built up by the joint efforts of you and Mr Cox and that the business of the Company would thereafter be sold, probably to an overseas advertising company. It was also intended that following that sale the Company would be wound up and the capital of the Company distributed in the proportions of you and your wife as to 80% and Mr Cox as to 20%."

This evidence led Santow J to make the following finding:

"In giving content to fairness, the shared expectations of Mr Cox and the controllers of F P Leonard, the Holt interests, are certainly not irrelevant. This is as they relate to future sale of the business and the intention that the benefit of that sale was to have been shared 80/20, whether through winding up or by equivalent means; see earlier quoted evidence of Mr Holt at pp93-4 of the transcript. A liberal estimate of the shares is the approach to be taken."

In argument, counsel for the appellants submitted that the trial judge misunderstood Mr Holt's evidence. According to Mr Pembroke QC, Mr Holt was saying no more than "I will not do anything to frustrate the benefits of the contract in the Special Resolution". I think that this does far less than justice to Mr Holt's evidence, but it is a reminder of the need for a valuer in the shoes of the hypothetical prudent purchaser to discount perhaps significantly in order to make proper allowance for the possibility that Mr Holt might not carry through on his earlier stated intentions.

I have already summarised the auditor's valuation report. As regards what I have termed the principal argument in the appeal, the auditor approached the matter this way: He recognised that there were competing valuation methods, and he sought to choose that which most accurately reflected the manner in which a willing but not anxious buyer would have approached the matter on 13 November 1990. Such buyer would be contemplating stepping into Mr Cox's shoes by acquiring the 5 "A" Class shares with their rights as stipulated in the Special Resolution. The auditor correctly recognised that the Special Resolution did **not** require the shares to be valued as if upon a winding up.

Pausing there, I can detect no error or misapprehension in these steps in the auditor's reasoning process: see ***Abrahams v Federal Commissioner of Taxation*** [1944] HCA 32; (1944) 70 CLR 23 at 29-30 (as to the general approach, and the relevance of the articles of association).

The auditor's choice as to valuation method, opting for one based on capitalisation of future maintainable dividends (with asset backing being considered merely as an assurance that returns would be maintained), is consistent with that adopted in a number of reported cases and texts: see Adamson, **The Valuation of Company Shares and Businesses**, 7th ed, 1986 pp55-8; Lonergan, **The Valuation of Businesses, Shares and Other Equity**, 1992, chapter 5. However, these do not purport to express an invariable principle. After all, a share is "more than a `capitalized dividend stream': it is a form of investment that confers proprietary rights on the investor": ***Gambotto v WCP Ltd*** [1995] HCA 12; (1995) 182 CLR 432 at 447 per Mason CJ, Brennan J, Deane J and Dawson J.

As Williams J pointed out in ***Abrahams*** (at 31):

"... it must be remembered that the value to be ascertained is the value to **the seller** *of the property in its actual condition at the relevant time ... with all its existing advantages and all its possibilities ...."*

In speaking of the "actual condition" of the property at the relevant time, Williams J in ***Abrahams*** was, I consider, emphasising the point that the prudent willing but not anxious buyer makes enquiries designed to find out real as distinct from theoretical possibilities, and the likelihood of them coming home. So long as that information was reasonably available, without breach of any duty of confidence, then the hypothetical purchaser would be presumed to have ascertained it: see ***Lynall v Inland Revenue Commissioners*** [1972] AC 680. In a passage from the judgment of Danckwerts J in ***In re Holt*** [1953] 1 WLR 1488 at 1501 that was quoted with approval by Lord Pearson in ***Lynall*** (at 705) it was said that:

"I think that the kind of investor who would purchase shares in a private company of this kind, in circumstances which must preclude him from disposing of his shares freely whenever he should wish (because he will, when registered as a shareholder, be subject to the provisions of the articles restricting transfer) would be different from any common kind of purchaser of shares on the Stock Exchange, and would be rather the exceptional kind of investor who had some special reason for putting his money into shares of this kind. He would, in my view, be the kind of investor who would not rush hurriedly into the transaction, but would consider carefully the prudence of the course, and would seek to get the fullest possible information about the past history of the company, the particular trade in which it was engaged and the future prospects of the company."

That prudent purchaser would also be expected to have regard to the stated intention of the owners of the controlling block of shares, even if those intentions may not necessarily be legally enforceable. In assessing the weight (if any) to be placed upon such matters, the prudent purchaser would try to form a judgment as to (a) the likelihood of the particular shareholders giving effect to their stated intentions as a matter of honour, and (b) the cost and likely success of litigation to enforce any legal and equitable rights flowing therefrom.

This point is also suggested in the following passage from Gibbs J's judgment in ***Gregory*** (at 567-8):

"... in my opinion it is not right to regard him in that statement as laying down an inflexible rule that in the case of an investment company the appropriate rate of capitalization is the average applicable to the investments held. The value of the shares in a holding company or an investment company must certainly be influenced by the value of the shares which it holds. Whether that influence on the value is overwhelming or not depends on all the circumstances. If the shareholding to be valued is a majority

holding the value of the underlying assets may assume great importance. Where, however, one is required to make a valuation of a minority shareholding in a company (Company A) which holds a very substantial parcel of shares in a public company (Company B), and when Company A is so controlled that it appears probably, if not certain, that it will, notwithstanding the fluctuations of the market, retain its shares in Company B, it would be quite unreal to say that a prudent purchaser of shares in Company A would necessarily expect to pay a price which would give a yield no greater than that produced by Company B, because on becoming a shareholder in Company A, he would not enjoy all the advantages available to a shareholder in Company B, and in particular would not be able to obtain the capital gain that would result from a favourable realization of the shares in the latter company. So to hold would be to substitute an artificial and arbitrary criterion for a test designed to establish a real value."

See also ***Federal Commissioner of Taxation v St Helens Farm (ACT) Pty Ltd*** [1981] HCA 4; (1981) 146 CLR 336 at 396.

There is, of course, a clear distinction between possibilities and realised possibilities: see ***Yates Property Corporation Pty Ltd (In liq) v Darling Harbour Authority*** (1991) 24 NSWLR 156 at 175-6 per Handley JA (and authorities cited). For that reason, it would have been quite wrong to have adopted the third valuation basis referred to in the report, ie one that assumed an immediate winding up. The contrary was not suggested.

Paras (25) to (33) of the auditor's report should now be set out:

(25) We have considered the asset backing of Leonard as a basis of valuation. In our opinion, however, for the purpose of this valuation, the asset backing is relevant only to an assessment of the apparent ability of Leonard to maintain estimated levels of profits in the future, rather than the basis for valuing the company.

(26) The main reason why this is not an appropriate valuation methodology in these circumstances is that the holder of the Share is ***only*** *entitled to receive a portion of the net assets on the* ***winding up*** *of Leonard. The Resolution provided that the holder of the Shares is entitled to receive "20% of any distribution of capital upon the* ***winding up*** *of Leonard".*

(27) We have, for the purpose of this report, interpreted the phrase "any distribution of capital" to mean "any distribution of surplus assets" after satisfying the claims of creditors and preference shareholders' prior entitlement to assets and dividends (that is, prior to ordinary shareholders) and that which is normally assumed in practice.

(28) In our opinion, the likelihood of Leonard being wound up is remote. We understand that liquidation was not contemplated at 13 November, 1990 and that in fact the company is currently in operation.

(29) Furthermore, if the majority shareholders wished to realise their investment, they would sell their shares in the company rather than wind up Leonard. Even if it was decided to wind up Leonard, it would be commercially logical for the majority shareholders to sell the business as a going concern (that is, without the "company" structure) and subsequently "strip" the profits from the company (by payment of dividends) or just "strip" the profits from the company as it is, via dividend payments and leave the par capital base. In doing this, the majority shareholders would maximise their net proceeds and would also avoid liquidation costs and discounts on disposal of assets during liquidation.

(30) Set out in Appendix A is a calculation of the net asset backing of the Shares assuming:

(a) the accumulated profits of Leonard have not been stripped;

(b) an allowance for the fact that the minority shareholders are in a disadvantaged position in relation to the overall ownership structure of the entity and the control over the assets of the company. We have reviewed the discount at which shares in companies listed on the Australian Stock Exchange (which have a strong net asset backing) are trading relative to their stated book value. Trades on stock exchanges are minority interest transactions, and as such they can provide an indication of discounts applying to minority shareholdings. This review supports the selection of a discount for a minority shareholding being in the range 40% and 60%;

(c) An allowance for lack of marketability of the Shares, compared with those shares listed on the Australian Stock Exchange, in the range of 25% and 30%. The application of a discount for the lack of negotiability is a subjective decision based on professional judgment and experience; and

(d) that the 5 shares are entitled to "20% of any distribution of capital".

(31) Even taking the most optimistic assumption, the theoretical asset backing of the Shares, based on the assumptions set out in paragraph 30, is in the range of $23,066 and $37,072. However, as discussed above, this is not a commercially realistic value (that is, it is only valid in the case of Leonard being wound up in the immediate future).

(32) Furthermore, even if the company was to be wound up, it is our view that a willing but not anxious purchaser would assume that the Ordinary Shareholders would reduce the net asset base by stripping the company of its accumulated profits before liquidating the company. Therefore, we have set out in Appendix B, a calculation of the net asset backing of the Shares, assuming that the total accumulated profits at 30 June 1990 have been stripped from Leonard. We have also assumed the same discount for lack of marketability and minority shareholding as set out in paragraph 30(b) and 30(c).

(33) On this basis the theoretical asset backing of the Shares, based on the assumptions set out in paragraph 32, is in the range of $3,798 and $6,103, however, as stated earlier, we do not believe this to be an appropriate valuation methodology in these circumstances.

From these extracts I would extrapolate the following conclusions about the auditor's approach to the possibility of the company being wound up:

(a) The auditor considered asset backing as relevant **only** to the assessment of the apparent ability of the company to maintain estimated levels of profits (see esp para (25)).

(b) In any event, the likelihood of the company being wound up was considered remote (para (28)). Reading para (28) as a whole and together with para (29), I infer that the auditor is addressing no more than the possibility of a forced winding up, in the sense of one initiated by persons other than the Holts acting in concert. On this limited basis, the particular "finding" of a remote likelihood was certainly open on the available material.

(c) In any event, the auditor found that the Holts would in the event of a sale be likely to use their powers in such a way as to maximise their position, even to the extent of "stripping" profits by dividend payments and leaving the per capital base (paras (29) and (32)). For reasons which are unexplained, no allowance appears to have been made for the holder of the 5 "A" Class shares getting the extraordinary value of the dividend stripping in this scenario (**ibid** and Appendix B).

(d) As the corollary of (c), the possibility that the Holts would use their voting power to ensure that Mr Cox would get the full value of 20% of an (unstripped) company in the event of sale was entirely disregarded.

The correctness of (d) is underscored by the following extract from Mr Adams' evidence, in which he was responding to questions asked by Santow J (T pp111-2):

Q. To take an extreme case you are saying that the effect of the special resolution, as you understood your task in determining fair price, was that if a sale were legally committed and were to take place the next day, that is to be completed the next day, and if Mr Cox were terminated the day before that fair price would have been $171?

A. I suspect it probably would, your Honour, because I think I would have had difficulty stepping outside the special resolution.

Q. If the shares were sold rather than the company, then what would you have said there?

A. I suspect, your Honour, that I would be in the same dilemma. I think I would still have to value them on the lower basis.

Q. If this were intended to be an incentive it would be an incentive that Mr Holt could render nugatory, even in circumstances of sale?

A. I think the answer to it is yes, your Honour. But I don't believe that would have been the situation. I believe that they are separate issues. I believe that the valuation of the shares by me as auditor in a technical matter is something that I am required to do and directed to do by the articles of association. I think that the fact that if the agency was sold and a profit arose from the sale of the agency or the sale of the shares I think that's a different matter, and I think that is a matter that Mr Holt would have to address. My belief is that Mr Holt would have addressed it.

Q. Leaving aside what Mr Holt might have done, you are saying in your view the words "fair price" in determining your task did not permit you to have regard to whether a sale was imminent or committed?

A. I believe so, your Honour, yes.

Not surprisingly, counsel for the appellants was at pains to stress that Mr Holt never had any intention of acting in the manner assumed by the auditor in paras (29) and (32) of his report and summarised by me in propositions (c) and (d). Indeed we were referred to evidence indicating that Mr Holt was a man who would be expected to act at all times in an honourable way. That evidence and that conclusion (which I accept) must be placed against the appellants' assertion of their legal rights to enforce the preemption right at the virtually nominal valuation determined by Mr Adams in his speaking valuation.

In my view, the auditor erred in his handling of the issue of winding up, and the errors exposed prevented the ensuing determination from being the "fair price" required by the Special Resolution. The auditor ignored entirely the possibility that sale might occur, and that in such event Mr and Mrs Holt would use their voting power (contrary to their financial interests) in such a way as to bring about the winding up of the company and the consequential realisation by Mr Cox of 20% of the liquidated value of the company. Had any regard been given to this possibility, the "fair price" must have been higher, no matter how significantly the possibility of such "voluntary" winding up should be discounted. (In June 1990, net assets stood at $591,905.) The possibility that this would come about should have been given some weight, having regard to the clear evidence about Mr Holt's stated intentions and the real possibility that he would give effect to them out of a mix of honour or recognised fiduciary obligation. As to the imminence of such a winding up eventuating, it was also relevant (as Santow J found) that turnover had (to the auditor's knowledge) climbed to the $8 million - $10 million figure that Mr Holt had told the auditor he had in mind as a trigger for a successful sale. I agree with the following extract from Santow J's conclusions:

"...[The] valuer correctly rejected the extremes of a valuation based on net asset backing or immediate winding up, but failed to take into account the effect on value of the **prospect** *of a future winding up.*

I am satisfied there was no such sale nor consequential winding up in **immediate** *prospect. Therefore what the valuer had to do, to take this into account, was to value the* chance *of sale and then determine the present value of twenty per cent of the surplus assets of F P Leonard at that future estimated sale date, undiminished by any stripping of profits. He finally needed to value this prospect from the viewpoint of the fiction of a willing but not anxious vendor, who in reality is forced to give up this prospect by selling. While I would not go so far as to hold that this justifies an additional premium in compensation for the forcible taking, the very notion of a* **fair** *price in such circumstances of expropriation requires that the valuer, in having regard to what is equitable and just, make his estimate on the liberal side in assessing that chance, within a range of possible values.* (emphasis in original)

In assuming that Mr Holt would act in the way outlined in para (32), the auditor flew in the teeth of Mr Holt's evidence, and the instructions set out in the letter from Phillips Fox placed before the auditor which I have already quoted. (I agree with Santow J's comment re this last mentioned matter: "To take this possibility into account is thus not, in my judgment, congruent with determining a *fair price*. Nor is it consistent with Mr Holt's own evidence.") The auditor ignored the very real possibility that the Holts would, as a matter of honour and/or fiduciary obligation, refrain from "dividend stripping" (excluding the holder of the Cox shares) as a means of defeating Mr Cox's expectations. If one is to read para (32) as suggesting that Mr Cox would share in the pre-liquidation dividend stripping (and this is not how I read

it), some allowance for the likelihood of that extraordinary windfall coming to pass should have been made.

Santow J adverted to the reality and genuineness of Mr Holt's stated intention in the following passage in his judgment:

*"In the context of mitigating or eliminating any discount, to be placed on minority interests in companies by reason either of restrictions on transfer without board approval (**Abrahams v Federal Commissioner of Taxation** [1944] HCA 32; (1944) 70 CLR 23), or of articles which give governing directors complete control to the exclusion of shareholders (**Abrahams** (supra) and **Kent & Martin v Federal Commissioner of Taxation** (Williams J, unreported), it has been recognised that these are fiduciary powers of the board, whose exercise is thus constrained. So they must be exercised by the board of directors bona fide for the benefit of the company and not oppressively. Furthermore, the possibilities of redress in the courts against misuse of such fiduciary powers, though not a substitute for articles without them, is not to be disregarded; **Gregory** (supra) at 569 per Gibbs CJ.*

In the present circumstances, by parity of reasoning, the court should not assume that directors of F P Leonard would have rendered nugatory or diminished the value of the Shares on winding up, by first stripping the company of its profits, thereby quite possibly behaving oppressively to the holder of the Shares. They would also quite possibly be breaching their fiduciary duties, particularly if the dividends were discriminatory, as this amount would reduce the twenty per cent on subsequent winding up.

*Indeed Counsel for the plaintiff acknowledged that if it were sought to deny Mr Cox the benefit of the winding up rights by contriving his dismissal just before a sale, of by structuring a post-sale position, whereby no winding up took place but a distribution by other means so as to thwart those rights, he would be entitled to sue the company for breach of the implied obligation not to thwart his obtaining the benefit of the contract; **Secured Income and Real Estate v St Martin's Investments Pty Limited** [1979] HCA 51; (1979) 144 CLR 596. Indeed any such action in that behalf was effectively disavowed by Mr Holt in his evidence, earlier quoted (at 93-4 of the transcript).*

It follows that when, in paragraph 32 of Mr Adam's valuation, he assumes that even if the company were to be wound up, it would be stripped of accumulated profits first, that assumption does not accord with the obligation not so to act as to thwart the giving of the intended benefit of the contract. Furthermore, in the circumstances, it may well be oppressive or in breach of the directors' fiduciary duties if that were attempted, as substantially diminishing the value of the Shares on later winding up. To take this possibility into account is thus not, in my judgment, congruent with determining a fair *price. Nor is it consistent with Mr Holt's own evidence."*

I would respectfully adopt this reasoning. Indeed, I would add express reference to the directly relevant remedy of winding up on the just and equitable ground. Breach of understandings and arrangements that fall short of legal duties may be remedied by winding up in an appropriate case: see ***Ebrahimi v Westbourne Galleries Ltd*** [1973] AC 360. I am not saying that the hypothetical prudent purchaser would have rated these legal and equitable rights as being in the category of a "sure thing". Indeed, that purchaser would prudently have discounted significantly having regard to the cost, effort, uncertainty and delay of litigation (cf ***Gregory*** at 569; Lonergan, ***op cit*** p72). However, to disregard the matter entirely, notwithstanding the clear instructions in the letter from Phillips Fox, strikes me as indicative of significant error, ie failure to have regard to the actual possibilities attendant upon this particular parcel of shares. I consider that failure resulted in the auditor not determining a "fair" value.

I acknowledge that the normal process of valuation assumes that the hypothetical vendor and purchaser will seek to maximise their own economic well being consistent with their legal rights (see eg Lonergan, ***op cit*** p8). But I would not elevate this to an invariable rule that requires the valuer to exclude entirely the possibility that those in control of a company may give effect to fiduciary obligations and/or duties of honour. The "fair price" which this auditor was to determine was one that had the historical context of the particular corporators of this particular company.

It was suggested by counsel for the appellants that the upholding of the respondent's case based on shared expectations as to the fructification of the winding up right would involve disregarding the trial judge's unchallenged finding that the appellant had not engaged in conduct in breach of s52, or alternatively

giving effect to statements of pre-contractual negotiations that are properly excluded by the parol evidence rule (cf ***Codelfa Construction Pty Ltd v State Rail Authority of New South Wales*** [1982] HCA 24; (1982) 149 CLR 337 at 352). I disagree. The matters which I have discussed at length are independently relevant because they are indicative of the real value of the Cox shares, with all their possibilities.

OTHER ISSUES

In view of the decision I have reached, it is not necessary to consider the respondent's fall-back position in which he contended that the auditor's determination may embody the lesser level of mistake that may lead to refusal of specific performance, leaving the parties with rights at law.

Nor is it necessary for me to decide whether what McHugh JA said in ***Legal & General*** may be distinguished on the basis that the contract there in question provided that the decision of the valuer was "final and binding on the parties". As presently advised, I am of the view that these words add little if anything to the situation. The very fact that the parties have nominated in their contract a procedure which delegates to an expert third party the right to determine value seems to import necessarily the agreement of the parties that such valuation will bind the parties so long as it is duly made. One is therefore brought back to the question: what classes of error (if any) prevent the determination from being duly made. Naturally this depends, in the final analysis, upon the terms of the contract.

Finally, I record that I have not thought it necessary to decide whether the determination is independently flawed for failure to have proper regard to the nuisance value of the right in the holder of the Cox shares to appoint a director. Given that a directorship carried no remuneration I would not think this right to be worth much, and accordingly am not presently persuaded that the auditor erred in his dealing with this issue. However I express no concluded view on that matter.

I would dismiss the appeal with costs.

COLE JA: The factual circumstances giving rise to this appeal, and the issues to be determined are set out in the judgment of Mason P which I have read in draft.

The appeal must be upheld if either:

(a) The valuation by the auditor was not erroneous, or

(b) The valuation by the auditor was erroneous, but the error was of a type which the parties by contract implicitly agreed to accept.

Mason P has enunciated three errors which Santow J found the valuer had made in making his valuation. They were:

(a) The failure to take account of the prospect of future fructification of the winding up right;

(b) The failure to take account of the shared expectations of Mr Cox and Mr and Mrs Holt; and

(c) The failure to take account of Mr Cox's continued right to appoint a director and his potential capacity to frustrate a future share sale by reason of his interest in 20% of the capital on winding up.

Those three errors were stated by Santow J in the following passages:

"It follows that when, in paragraph 32 of Mr Adam's valuation, he assumes that even if the company were to be would up, it would be stripped of accumulated profits first, that assumption does not accord with the obligation not so to act as to thwart the giving of the intended benefit of the contract. Furthermore, in the circumstances, it may well be oppressive or in breach of the director's fiduciary duties if that ere attempted, as substantially diminishing the value of the shares on later winding up. To take this possibility into account it is thus not, in my judgment, congruent with determining a *fair* price.

In the present circumstances, there is a compulsory purchase and *fairness* of price is the explicit contractual criterion. It is thus appropriate to look at matters first from the vendor's point of view, in considering the rights of the shares and what, to the vendor, they may be expected to yield him in the future by way of benefits, for loss of which a fair sale price is compensation. This is particularly when, as here, the vendor has no choice but to sell. It is necessary to ask what a willing, but not anxious vendor would consider "a fair price" for being deprived of these shares "with (all their) existing advantages and with (all their) possibilities ..., not what the purchasers with their greater bargaining power might in reality be able to extract on a compulsory sale. In giving content to fairness, the shared expectations of Mr Cox and the controllers of F P Leonard, the Holt interests are certainly not irrelevant. This is as they relate to future sale of the business and the intention that the benefit of that sale was to have been shared 80/20, whether through winding up or by equivalent means; .... A liberal estimate of the shares is the approach to be taken.

Furthermore their value to the purchaser, ignoring the purchaser's expropriatory power (except as justifying a liberal estimate) must reciprocally be taken into account in determining a fair price. This is precisely as Mr Cox's continued shareholding rights do detract from the remaining shares, and giving him a directorship when no longer employed and the continued capacity to frustrate a sale or bargain with some leverage for a share in it."

THE LEGAL CONCEPTS

The parties were in agreement that Mr Adam had acted honestly and impartially in valuing the shares as an expert. His task, in accordance with the terms of the agreement between the parties contained in the articles was, upon termination of Mr Cox's employment on 13 November 1990, to determine "a fair price" for the five A class shares which, under the articles, Mr Cox was obliged to offer to Mr and Mrs Holt. The shares had attached to them the right to appoint a director, the right to receive such dividends as may be declared by the directors from time to time, and the right on a winding up to receive 20% of any distribution of capital.

The contract did not provide that Mr Cox was obliged to offer his shares to the Holts at a price determined as fair by a party other than the auditor. It did not permit a court to determine on some supposed empirical basis what was fair and to compare that determined value with the valuation achieved by Mr Adams as auditor, and to strike down as unfair his valuation if it did not accord with that of the Court. Once it is accepted that Mr Adams acted both honestly and impartially, it cannot be said that he was not acting fairly as between the parties in fixing his valuation or that the price he determined was not a "fair price". In my view there is no room for the Court to determine in those circumstances that failure to take into account any particular factor destroys between the parties the contractual integrity of Mr Adams valuation.

McHugh JA, to my understanding, recognised this in Legal & General Life of Australia v A Hudson Pty Limited[1]. His Honour said:

"As Sir David Cairns pointed out, it is easy to imply a term that a valuation must be made honestly and impartially. It will be difficult, and usually impossible, however, to imply a term that a valuation can be set aside on the ground of the valuer's mistake or because the valuation is unreasonable. The terms of the contract usually provide, as the lease in the present case does, that the decision of the valuer is "final and binding on the parties". By referring the decision to a valuer the parties agree to accept his honest and impartial decision as to the appropriate amount of the valuation. They rely on his skill and judgment and agree to be bound by his decision.

....

But as between the parties to the main agreement the valuation can stand even though it was made negligently. While mistake or error on the part of the valuer is not by itself sufficient to invalid the decision or the certificate of valuation, nevertheless the mistake may be of a kind which shows that the valuation is not in accordance with the contract. A mistake concerning the identity of the premises to be valued could seldom, if ever, comply with the terms of the agreement between the parties. But a valuation which is the result of the mistaken application of the principles of valuation may still be made in accordance with the terms of the agreement. In each case the critical question must always be: was the

valuation made in accordance with the terms of a contract. If it is, it is nothing to the point that the valuation may have proceeded on the basis of error or that it constitutes a gross over or under value. Nor is it relevant that the valuer has taken into consideration matters which he should not have taken into account. The question is not whether there is an error in the discretionary judgment of the valuer. It is whether the valuation complies with the terms of the contract."

Here the contract required the determination of a valuation which was, in the honest and impartial view of the auditor, a fair valuation of the shares having the characteristics mentioned. The use of he expression "fair" does not, in my view, permit a third party, here the Court, to substitute its view for the view of the valuer, or to say that the auditor's valuation is unfair, and therefore not in accordance with the contract, because the Court takes the view that the valuer has disregarded what the Court considers to be a material factor in the valuation. The parties have entrusted the determination of a fair valuation to the auditor, not to the Court.

This view, in my judgment, is consistent not only with the view of McHugh JA but that of the Full Court of the Supreme Court of Victoria in Email Limited v Robert Bray (Langwarrin) Pty Limited[2]. Their Honours said:

"In our opinion, the parties have clearly bestowed upon the valuer the obligation of determining what circumstances are relevant to the question of fixing "a reasonable rental". We do not consider that the Court should make a declaration which delineates the circumstances to which the valuer should have regard. The declaration that we are disposed to make is that "a reasonable rental;" means a rental which the valuer considers is reasonable having regard to all the circumstances which the valuer considers are relevant".

Similarly, here "a fair value" means a value which the valuer, Mr Adams, considers is fair having regard to all the circumstances which the valuer considers are relevant.

It also accords with the view of the English Court of Appeal in Jones v Sherwood Services PLC[3] where Dillon LJ, with whom Blacombe LJ agreed, cited with approval Lord Denning's judgment in Campbells v Edwards[4]:

"If two persons agree that the price of property should be fixed by a valuer on whom they agree, and he gives that valuation honestly and in good faith, they are bound by it. Even if he made a mistake they are still bound by it. The reason is because they have agreed to be bound by it. If there were fraud or collusion, of course, it would be very different. Fraud or collusion unravels everything."

To my mind these statements of principle can not be circumvented by a court by emphasising or relying upon qualifying words such as "fair" or "reasonable" to then hold that omission properly to consider, in the Court's view, a factor, or taking into account, in the court's view, an irrelevant factor vitiates the valuation honestly and impartially made by the person to whom the contracting parties have entrusted that task. To do so is in truth to substitute the valuation of the court for the impartial valuation of the person to whom the parties have, by their contract, entrusted the valuation task. The contract between the parties was not that the auditor should determine a price for the shares which a court must be satisfied was fair. The contract was that the auditor should, impartially and honestly, determine what in his opinion was a fair price, and the parties agreed to accept that valuation.

It follows, in my judgment, that the appeal must be upheld.

DID THE AUDITOR ERR?

In my view he did not. The contract between the parties required the auditor to value the shares at the date of termination of Mr Cox's employment, 13 November 1990. Whatever may have been the intention of the parties at the time when the article was agreed which required the valuation to be made at that date, that was the contract finally agreed as embodied in the special resolution. The auditor held, correctly, that at that time "the liquidation was not contemplated". There was thus no immediate or reasonable prospect of the holder of the shares obtaining a benefit in consequence of that provision. The auditor thought that any such benefit flowing to the shares on a winding up had little value stating that the theoretical asset backing did not give a "commercially realistic value" because "it is only valid in the case of Leonard

being wound up in the immediate future". He thus rejected a valuation based upon the methodology of determining surplus assets as though on a winding up, in favour of determining that the proper method of valuation was a value determined by reference to the income stream which the shares might produce. To my mind the parties clearly agreed that the valuer could determine the proper method of valuation. Having determined upon a method related to the valuation of a prospective income stream, being a method in which rights attaching on any future winding up have no bearing, it cannot be said that he erred in disregarding the circumstance of a winding up, being an event he found to be not in contemplation.

Much emphasis was placed by the respondents upon the evidence related the derivation of the agreement contained in the articles, and of Mr Holt's evidence that he would abide by the terms of the contract contained in the articles. In my view the evidence concerning the discussions prior to the agreement, contained in the articles, was irrelevant. Evidence of intention thereafter was relevant only to the question of whether or not a winding up was imminent such that it could be said that the valuer could not have acted honestly or impartially in selecting a method of valuation which ignored value attaching to the shares because of an imminent winding up and distribution of assets. In any event, the evidence of Mr Holt[5] was simply that if a winding up occurred whilst Mr Cox remained a shareholder, he would receive 20% of the assets. A winding up did not occur whilst he was a shareholder, nor was it in prospect. His evidence was:

"Q. I am simply putting aside when you in fact fired him and simply ask the question hypothetically.

A. **Hypothetically if this was not resolved** and somebody came to me today and bought the agency, he would get his 20%.

Q. Assuming he were fired - assume these facts, that you know sale is about to take place, and that he was still in the employment of the company?

A. Yes.

Q. Would it have been your intention, **looking at the time the resolution was first passed**, and without the wisdom of hindsight, would it have been your intention that you would be free to terminate his employment just prior to sale?

A. Oh, gosh, no, and I said to you if I sell today he gets 20%. I will honour that **until the shareholding is decided otherwise**." (Emphasis added)

In my opinion the valuer made no error. If he did, the parties agreed to accept his honest and impartial although erroneous valuation of his determination of a fair value for the shares..

That being so, I can see no basis upon which the respondent could resist an order for specific performance of the obligation to offer the shares to Mr and Mrs Holt at the price determined by the auditor.

I would propose that the appeal be allowed, the orders of Santow J of 15 December 1994 be set aside and that in lieu thereof it be declared that the valuation of Mr Adam dated 4 June 1991 of the shares held by the respondent in F B Leonard Advertising Pty Limited is the determination of a fair price within the meaning of the Articles of Association of that company, and that the respondent be ordered to offer the five A class shares held by him to Geoffrey Allen Holt and Valerie Ann Holt at the price so determined. The respondent should pay the appellant's costs of the proceedings before Santow J and of the appeal but should have, if qualified, a certificate under the Suitors Fund Act in respect of the costs of the appeal.

PRIESTLEY JA: I agree with Mason P.

[1] (1985) 1 NSWLR 314 at 335 - 6.

[2] [1984] VicRp 2; (1984) VR 16 at 21 per Crockett, Kaye and Gray JJ.

[3] (1992) 1 WLR 277 at 279.

[4] (1976) 1 WLR 403 at 407.

[5] Transcript, p.94.

AustLII: Copyright Policy | Disclaimers | Privacy Policy | Feedback
URL: *http://www.austlii.edu.au/au/cases/nsw/NSWSC/1997/144.html*