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Shareholder Disputes – Standard of Value

Shareholder and partner disputes may arise for various reasons:

- oppression of minority shareholder
- death of a shareholder
- fallout between owners over compensation.

Parties to these disputes should be cognisant of the nuances that may be involved in the valuation of interests in closely held businesses in such matters, including the appropriate standard of value to be applied.

A minority interest holding carries the right to vote but does not confer control over the company. A minority interest holding has no direct access to the cash flows and is entitled only to dividends, the amount and timing of which is determined by the directors of the company (usually the major shareholder). A minority interest holding is hard to sell (there is not a ready market).

The majority shareholder controls —

- the board and the management of the company
- all decision making
- voting rights in both general resolution meetings, and
- dividend policy

— but still needs to have regard to the interests of the minority interest shareholder.

It is normal commercial practice that minority holdings are discounted for their lack of marketability and minority status from their pro-rata value for the factors outlined above.

One issue when valuing shares/equity in shareholder disputes involves the appropriate standard of value to be applied in deriving the value of the relevant business interest.

Valuation theory generally recognises several standards of value applicable in the valuation of an interest in a closely held business, including **fair market value** and **fair value**. The appropriate standard of value in shareholder matters is generally driven by statutes and case law.

The **fair market value** of a business or an interest in an entity refers to the amount that could be exchanged between a knowledgeable and willing buyer and a knowledgeable and willing seller in an arm's length transaction.

Generally, **legal** interpretations of the "fair value" concept are based on the proposition that "fair value" reflects the desire to be equitable to both parties and recognises the fact that the transaction is not in the open market, and that both the buyer and seller have been brought together by the operation of a legally binding agreement in a way that excludes other potential buyers and sellers.

To determine fair value on this basis, the valuer is required to take into account what the seller gives up in value and what the buyer acquires in value through the transaction, or the value of the shares/units being transferred to both the buyer and seller. This is often referred to as what is "just and equitable".

Typically, no discount for lack of control and lack of marketability is applied under the fair value standard. The rationale being that to permit the majority to compulsorily acquire the minority interest at a price which reflects the effect of the oppressive conduct would only provide the majority with an incentive to oppress.

Minority Oppression

Minority oppression actions are founded in the Corporations Law. Section [232](#) of the [Corporations Act 2001 \(Cth\)](#) (the Act) sets out the grounds on which a court may make an order under section [233](#). This section states the court may make an order for the company to compulsorily acquire or buy out the affected shareholder's shares if the conduct of the company's affairs, or an actual or proposed act or omission by or on behalf of a company, or a resolution or proposed resolution, is either:

1. contrary to the interests of the members as a whole; or
2. oppressive to, unfairly prejudicial to, or unfairly discriminatory against, a member or members.

Examples of oppressive conduct include:

- running the company in their own interest and ignoring the interests of minority shareholders
- improperly issuing shares to themselves to outvote other shareholders
- excluding a minority shareholder from being involved in the management decisions of the company
- redirecting business opportunities from the company to themselves, or
- paying themselves excessive salaries at the expense of dividends to the shareholders.

In most oppression cases, the courts have adopted a "fair value" standard and do not discount the value of the shares.

Other Shareholder Disputes

A valuation may also be required in a variety of other disputes amongst shareholders or partners, including the terms of a buy-sell agreement or transactions involving new or departing shareholders or partners.

Also, rather than instigate action under the oppression laws of the Act, parties may agree for a valuer to conduct an Expert Determination.

These matters are often guided by shareholder agreements or other documents controlling the relationship of the owners of a business.

Whilst many shareholder agreements refer to **fair value** rather than **fair market value**, some shareholder agreements do not articulate which is applicable.

The valuer therefore needs to make a decision as to which standard applies. We have come across this

situation on occasions. Factors we consider include:

- Will the transfer give the majority shareholder 100% control? In public company takeovers, minority shareholders are typically offered a premium to reflect full 100% pro-rata value of the company.
- What agreements are in place?
- What is the dividend history of the company?
- Does the business appear to have operated as a “quasi-partnership” as evidenced by:
 - the relationship between the shareholders, formed or continued on the basis of mutual trust and confidence
 - both participating in the management of the business and both being directors.
- Has any oppressive action occurred?

If the fair market value standard is considered applicable, then a determination of the amount of discount for lack of marketability and minority holding is required. Discounts can range from 5% to as much as 50%. Factors to consider in determining the appropriate discount include:

- What does the shareholder agreement say? It may provide directions regarding value when there is a transfer of shares.
- What is the composition and role of the other shareholders? Important benchmark holdings are:
 - > 75% control – can pass special resolutions
 - > 50% control – can remove directors
- What role does the shareholder have in the company’s affairs?
- Is a quasi-partnership considered to be in operation?
- Is a sale of the business being contemplated? — then no grounds for a discount.

Harmonisation of Expert Witness Codes of Conduct

The harmonised expert witness code of conduct was developed by a committee established by the Council of Chief Justices.

In Victoria on 1 June 2016 the [Supreme Court \(Chapter I Expert Witness Code Amendment\) Rules 2016](#) substituted as Form 44A the “Expert Witness Code of Conduct” (the Code), being a national code for expert witnesses as recommended by the (Australasian) Rules Harmonisation Committee and approved by the Council of Chief Justices. The Code is similar to the previous Form 44A code. The Code applies to any expert witness engaged or appointed to provide an expert’s report for use as evidence in a proceeding or to give opinion evidence in a proceeding. The Code sets out the general duty of an expert witness to assist the court impartially on matters relevant to the area of expertise of the witness. Practitioners are reminded of their obligation under Rule 44.03 of the Supreme Court (General Civil Procedure Rules) 2015 to provide a copy of the Code as soon as practicable after the engagement of an expert whose evidence is to be adduced at trial.

Other courts that have adopted the harmonised expert witness code to date are:

- Supreme Court of Tasmania 6 January 2016
- Supreme Court of the ACT 1 July 2016
- Federal Court of Australia 25 October 2016
- Supreme Court of NSW 9 December 2016

The majority of the differences between the repealed and current code appear to reflect semantic rather than substantive issues. A copy of the harmonised expert witness code can be downloaded [here](#).

Recent Matters

In the past 6 months we have been very busy working on numerous matters including:

- loss of earnings assessments for people diagnosed with mesothelioma
- expert opinion as to whether trustees of a superannuation fund have correctly calculated a member's entitlement
- loss and damage incurred on eviction from leased premises
- assessment of loss and damage incurred by franchisee as a consequence of misleading and deceptive representations by franchisor
- Expert Accounting Opinion relating to the accounting treatment of certain income received by an aged care provider
- reconstruction and reconciliation of joint venturers loan accounts and funding arrangements
- valuations (for a variety of purposes including shareholder disputes, family law, tax restructuring, sale and acquisitions) of:
 - internet service provider
 - salary packaging business
 - intellectual property
 - electrical contractor
 - advisor to international fund managers
 - construction businesses
 - cafes and restaurants
 - liquor shop
 - supermarket
 - plumber
 - boiler installation and service
 - franchisee businesses
 - building survey and mapping
 - financial planners
 - car detailer
 - steel fabrication
 - sign writing
 - wholesale fruit and vegetables
 - real estate agency
 - tattoo parlour
 - gear manufacturer
 - game developer
 - panel beaters
 - wholesale businesses
 - accounting practices
 - landscaping
 - air conditioning distribution and service



Munday Wilkinson Chartered & Forensic Accountants



Russell Munday



Bruce Wilkinson

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- Due Diligence Reviews
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- Due Diligence services
- Expert Determinations
- Expert Witness

We can provide forensic accounting services for a wide variety of dispute related matters from the small to the large.

Further Information

If you would like further information regarding this newsletter or our services, please contact us:

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