Dispute Resolution

Application of Discounts in Valuing Shares for a Buy-Out Order Where There is No Finding of Oppression

Introduction

Where the affairs of a company have been conducted in a manner oppressive to some of its shareholders, the court may make an order for the purchase of their shares by the other shareholders. The shares will be valued with the objective of remedying the oppression suffered. If, however, the parties consent to an order for the purchase of shares without a determination of liability for oppression, how should the shares be valued? If the parties cannot agree which party should purchase the other party's shares, how should that affect the valuation? Should discounts be applied for lack of control, if those shares are a minority shareholding, and for any lack of marketability of those shares? These were the questions faced by the Singapore Court of Appeal in *Liew Kit Fah and others v Koh Keng Chew and other* [2019] SGCA 78.

The High Court had held those discounts should not be applied. But, in a highly significant decision, the Court of Appeal reversed the High Court's judgment. The Court of Appeal accepted the Appellants' argument that as there was no finding of oppression under section 216(1) of the Companies Act ("**Act**"), the buy-out order had been granted under the parties' consent order, not under section 216(2) of the Act to remedy any oppression allegedly suffered by the Respondents. Accordingly, as the Appellants had argued, the Respondents were to be treated as a willing seller and the Appellants a willing buyer of the shares. As the objective was to determine their fair market value, the discount for lack of control would be applied and the appointed independent valuer was to decide whether a discount for lack of marketability should be applied.

The Appellants were successfully represented before the Court of Appeal by Patrick Ang, Jared Kok, Derek On and Torsten Cheong of Rajah & Tann Singapore LLP.

Brief Facts

The Appellants held a majority of the shares in a group of companies and the Respondents held a minority of those shares. The Respondents commenced suit against the Appellants, alleging oppression, but the parties later compromised the action. They recorded their consent not to determine liability for oppression, to an order for one side to purchase the other side's shares, and for the court to determine who should buy out whom, which they could not agree as each wanted to buy out the other. In the consent order, they also agreed that the price should be determined by an independent valuer.

After the High Court ordered the Appellants to purchase the Respondents' shares, the valuer referred to the High Court the question whether discounts for lack of control and lack of marketability should be applied in determining the price of the shares. This issue was not addressed in the consent order. The High Court held that both discounts should not be applied. The Appellants appealed.

The Court of Appeal's Decision

By a majority of two to one, the Court of Appeal allowed the appeal. In brief, the Court held that:

(a) The buy-out order was not made pursuant to the court's power under section 216(2) of the Act;
(b) The sale of the Respondents' shares to the Appellants was akin to a sale between a willing seller and a willing buyer;
(c) The independent valuer was to apply a discount for lack of control; and
(d) The independent valuer was to decide whether it was appropriate to apply a discount for the lack of marketability.

The Court of Appeal held that the High Court was wrong to treat the case as one involving an innocent minority and a delinquent majority. It was clear from the statutory text that the court's power under section 216(2) arose only where oppression under section 216(1) had been established. Here, there was no finding of oppression. Therefore, the buy-out order could not have been made under section 216(2).

Whether the discounts ought to apply depended largely on whether the Respondents could be treated as willing sellers of their shares. If so, then the valuation would be directed at determining a fair market value, which ordinarily involved applying the relevant discounts. An unwilling seller for this purpose was not one who had entered into the sale without any complaint, but one for whom it would no longer be tolerable to continue as shareholder of the company because of the other shareholders' proven misconduct in relation to the affairs of the company.

Here, although the parties did not agree who should buy out whom, their unwillingness to sell did not result from the other party's unfair prejudice. By the consent order, both parties, including the Respondents, had in effect agreed to the potential sale of their shares despite their preference to the contrary. The Respondents were therefore akin to a willing seller of their shares.

Accordingly, the discount for lack of control ought to apply to reflect the fair market value of the shares. It was argued that this discount should not apply because there was no question of lack of control given that the Appellants had a majority of the shares and would after the purchase collectively own 100% of the shares. The Court rejected this argument, holding that the Respondents were not a monolithic majority shareholder which would vote in support of each other at all times, and instead comprised disparate individuals who held a majority of the shares and were majority shareholders only for the purposes of this case.

Whether a discount for lack of marketability should be applied was industry specific and was therefore a matter appropriately left for the valuer to determine according to his expertise.

The Court highlighted in closing that outside the oppression context, the courts could not be an avenue through which a minority shareholder obtained a price higher than what he could have obtained had he gone through the usual process of selling his shares to the remaining shareholders. Otherwise, a disgruntled minority shareholder might be encouraged to commence an oppression action and then compromise the action by consent as a tactic to put himself in a better position than he would have been in had he invoked the process of sale under the company's articles. Shareholders who sought to resolve their differences by recording their consent to a buy-out order should be aware of this, but were also free to address the question whether any discounts should be applied in their consent order.

The minority judgment agreed that the High Court was wrong to treat buy-out order as having been made under section 216(2). However, the minority did not think the circumstances of the case warranted an application of the discounts. The minority also considered that the precise jurisdiction of the court to make a buy-out order where an oppression action had been compromised under a consent order was not fully resolved and would have to be addressed by the Court of Appeal in an appropriate future case.

Concluding Words

The key takeaway from the Court of Appeal's decision is that parties, especially parties seeking to be bought out, must be scrupulous as to the terms of any consent order they agree in compromising an action for oppression. Matters which can be agreed are not restricted to liability for oppression and the provision of a buy-out order. The party seeking to be bought out may also negotiate to exclude the application of any discount on the price. To hedge against uncertainties relating to the nature of the court's jurisdiction to make a buy-out order under a consent order, the parties may even wish to agree that neither side will dispute that jurisdiction and that each party shall have the right to appeal against any decision of the High Court on substantive matters relating to the consent order, such as a decision on the reference date for the valuation.

The Court of Appeal's decision also provides useful clarity on the meaning of a discount for a lack of control and a discount for a lack of marketability. The price of shares may be discounted for lack of control because they would not confer on the shareholder control over the management decisions of the company. That price may also be discounted for lack of marketability because the shares are those of a private company and are therefore more difficult to dispose of because of transfer restrictions typical in that context or because of reasons specific to the industry in which the company operates. While the court would be willing to decide whether a discount for lack of control should apply, it would be inclined to leave it to the valuer whether a discount for lack of marketability should apply. This should help parties decide the matters on which they should address the court and the matters on which they should address the appointed valuer.

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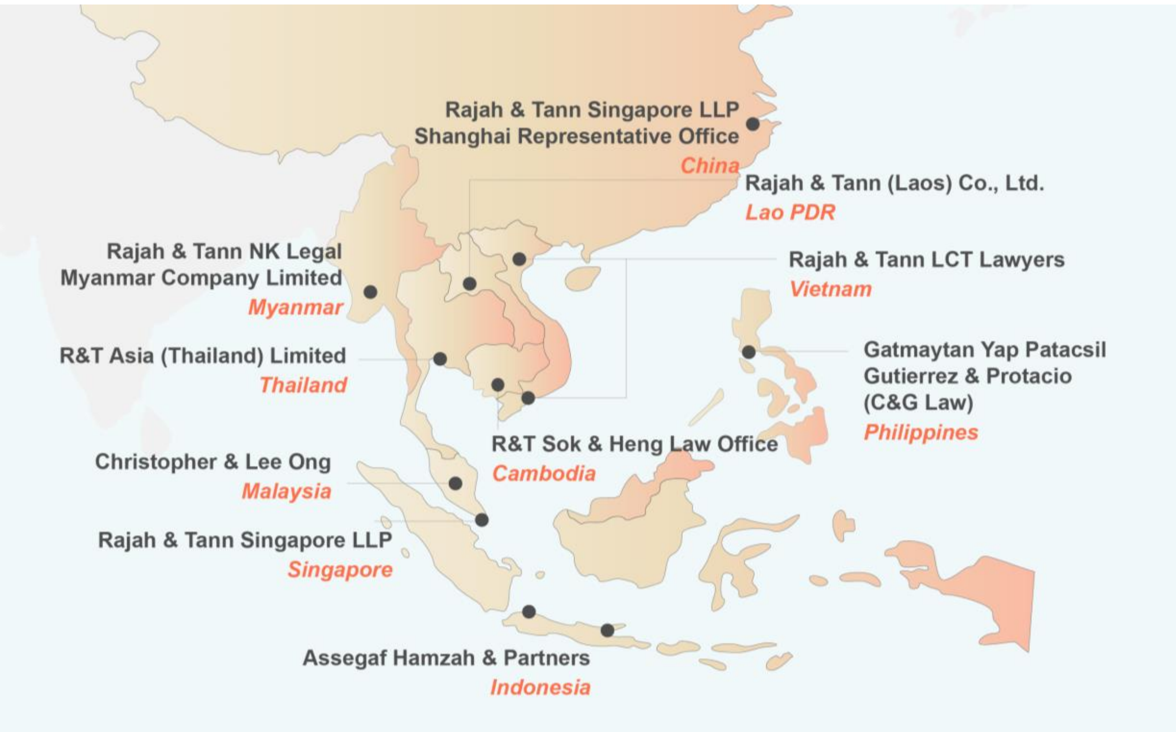

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