OUTER HOUSE, COURT OF SESSION

[2021] CSOH 109

P416/19

OPINION OF LORD CLARK

in the petition of

CHARLES MARTIN

Petitioner

against

(FIRST) THOMAS HUGHES

(SECOND) HENRY CLARK SEDDON

(THIRD) RAM 232 LIMITED

Respondents

Petitioner: Gillies Sol Adv; Pinsent Masons LLP
Respondents: MacColl QC, McKenzie; Wright, Johnston & Mackenzie LLP

26 October 2021

Introduction

[1] The petitioner is a minority shareholder in a limited company which provides accountancy services. It was previously named Gerber Landa and Gee Limited and is now RAM 232 Limited ("the Company"). The business formerly operated as a partnership. The petitioner seeks orders under sections 994 and 996 of the Companies Act 2006 on the grounds that the affairs of the Company have been conducted in a manner that was and is unfairly prejudicial to the interests of the members, including himself. He seeks relief in the

form of a compulsory purchase of his shares in the Company by the respondents. The respondents deny any unfairly prejudicial conduct. The parties are also in dispute as to the fair value of the petitioner's shares, based on the evidence of their respective experts, should the shares require to be purchased. The case called before me for a proof before answer, with six days of evidence followed by one day of oral submissions.

Background

[2] On the evidence, and in part agreed by joint minute, the factual background is as follows. The Company was incorporated on 18 April 2013. Its original directors and shareholders were the petitioner, the first respondent (Mr Hughes), the second respondent (Mr Seddon) and James Murphy. The petitioner, Mr Hughes and Mr Murphy each came to hold 1500 shares and Mr Seddon held 500 shares. The four individuals were previously the partners in the partnership, with the trading name of Gerber Landa & Gee. On 21 November 2013, shortly before the transfer of the business, assets and goodwill of the partnership to the Company (which occurred on 1 December 2013) the directors and shareholders of the Company entered into a Minute of Agreement. The Minute of Agreement dealt primarily with the repayments of directors' loans which arose from the disposal of the goodwill of the partnership to the Company. The goodwill figure was £1,100,000 and the allocation of goodwill payments was £350,000 to the petitioner, Mr Hughes and Mr Murphy and £50,000 to Mr Seddon. The Minute of Agreement states that on exit, a departing director would be entitled to "repayment of his share value" in addition to his loan account.

[3] Incorporation of the Company had been under consideration for a period of time, but the matter was brought to a head as a protective measure as a consequence of a police

investigation into the partnership. The investigation arose as a result of an entity described as Mathon Finance going into administration. The partnership had been the auditor of two companies related to that entity, Mathon plc and Bathon Limited. The police investigation was a concern for the directors of the Company. Mr Murphy had been involved with the auditing of these companies. The companies were associated with Heather Capital Ltd, whose liquidators were involved in various actions against, among others, professional advisors. Material was discovered which the other directors considered indicated misconduct on the part of Mr Murphy. It was made clear to Mr Murphy by all of his fellow directors that he required to resign from the Company immediately and that the balance due on his director's loan account was subject to review in light of any adverse financial consequences arising from the Mathon affair. Mr Hughes and Mr Seddon considered that the Company remained exposed to a financial claim arising from Mr Murphy's conduct. On 20 March 2015 at a meeting between the original directors and shareholders Mr Murphy resigned as a director of the Company and agreed that his shares could be transferred to the other shareholders. The shareholding of the Company became 2,142 ordinary shares for the petitioner and Mr Hughes and 716 ordinary shares for Mr Seddon. That remains the position. Mr Murphy remained a creditor of the Company in terms of his director's loan account. The debt continued to be paid to Mr Murphy from March 2015 until approximately August 2017. The payments stopped after Mr Murphy was investigated by the Institute of Chartered Accountants in Scotland ("ICAS") and the Investigation Committee determined there was sufficient evidence to establish a charge of professional misconduct.

[4] In 2017 the petitioner, Mr Hughes and Mr Seddon were attempting to implement a succession plan which had been under consideration for a few years. The succession plan envisaged a management buyout ("MBO") with the three directors remaining as consultants

for a period. In or around April 2017, the relationship between the petitioner and Mr Hughes deteriorated. Around this time Mr Hughes wished to provide additional compensation to Mr Seddon for his work. The petitioner indicated he would give it consideration. In July 2017 Mr Hughes again raised the subject and suggested a bonus of £90,000 to Mr Seddon. The petitioner disagreed with that suggestion and it was not taken forward.

[5] In July 2017 the Company approached David Thompson, advocate, for advice on the issues with Mr Murphy and the director's loan account payments to him. Counsel produced his opinion and met with the petitioner, Mr Hughes and Mr Seddon on 4 August 2017. Given that the Company had continued to make payments to Mr Murphy throughout the period of having been aware of Mr Murphy's wrongdoing, counsel raised the issue of personal bar in the event of a claim by the Company against Mr Murphy. Counsel advised that further payments to Mr Murphy would be prejudicial to the Company. Counsel did not expressly advise against trying to extra-judicially resolve the dispute between the Company and Mr Murphy. Following the meeting with counsel there was a difference of opinion between the petitioner and Mr Hughes and Mr Seddon as to how to deal with the matter. The petitioner met with Mr Murphy. During their discussions Mr Murphy explained that his financial position was not good. They discussed whether matters could be settled. The petitioner made an offer personally to pay money to Mr Murphy. Mr Hughes and Mr Seddon, when informed of the petitioner's approach to Mr Murphy, considered this was contrary to the board's strategy and counsel's advice. The relationship between Mr Hughes and the petitioner deteriorated further.

[6] In early August 2017, the petitioner desired that the Company should follow the usual policy of payment of dividends when there were funds available, and in particular

due to reduction in a corporation tax provision. He wrote to Mr Hughes referring to the fact that the Company was on target for this year's budget and the cash position was positive. Mr Hughes did not agree and stated that he wished to set aside a substantial sum of money to fund any defence and counterclaim in the event of a claim for payment from Mr Murphy.

[7] On 26 September 2017 Mr Hughes and Mr Seddon served a special notice of the intention to remove the petitioner as a director at an extraordinary general meeting ("EGM"). The meeting was to take place on 14 November 2017. The petitioner decided to resign. He worked for the Company until 28 September 2017. The petitioner then cleared his desk that weekend and posted his resignation to the Company on the afternoon of Friday 29 September 2017, which took effect on Sunday 1 October 2017. After his resignation, two major clients left the Company and the petitioner took on consultancy work involving existing clients of the Company. This was separate from audit, accounting and taxation-compliance services. He performed advisory and consultancy services under mandates to twenty-nine clients.

[8] In terms of service agreements entered into between the Company and the individuals after the resignation of the petitioner, the remuneration of Mr Hughes was £96,000 per annum and Mr Seddon's remuneration was £60,000 per annum. Under the agreements, they were also allowed a bonus from time to time taking into account the Company's profits and cash position on a quarterly basis. A valuation instructed by the board of the Company and prepared by Milne Craig in October 2017 ("the October Valuation") following the petitioner's resignation valued the goodwill in the Company at £710,000. This included provision of £72,000 for the loss of certain of the largest clients of the Company after the petitioner's resignation. Shortly thereafter, two individuals who had done work for the petitioner within the Company accepted voluntary redundancy. A

revised valuation prepared by Milne Craig in November 2017 ("the November Valuation") reduced the value of the goodwill of the Company to £545,000. This included a revised provision of £102,000 for the loss of clients. The petitioner's share of goodwill was valued at £230,000 after excluding his consultancy income and the effect of the lost clients. The Company's other assets, less its liabilities, were valued at £847,818. Mr Hughes and Mr Seddon called an EGM on 12 December 2017 to consider a resolution to grant floating charges in their favour by the Company. The petitioner appeared by proxy and voted against the resolution which was passed with a majority on the votes of Mr Hughes and Mr Seddon.

[9] On 3 January 2018, a senior person in the MBO team, Lorna Gray, wrote to Mr Seddon indicating that the team would only purchase certain assets of the Company, and not the shares, due to ongoing legal issues. The proposed purchase was at a price of £475,000 paid over three years (with an initial payment of £175,000 and 12 quarterly payments of £25,000) with a retention of £75,000 and an additional £1,000 for fixtures and fittings and computer equipment. On 3 January 2018, Mr Hughes sent the offer to Craig Butler of Milne Craig to consider it as confidential to the board only and specifically not to be disclosed to the petitioner as a shareholder. Mr Hughes asked for confirmation that a deal at that price "would not be unreasonable". On 5 January 2018 Craig Butler responded that it "appears reasonable given ongoing uncertainty around client retention" citing "the extent to which clients have been mandated by [the petitioner] has increased" and that "as such it is not unreasonable to expect that the goodwill associated with the practice has fallen since our report was issued". Milne Craig were not asked to prepare a revised valuation. The effect of the reduction in the price was to reduce the petitioner's share of goodwill at the sale date from £230,000 to £5,000 due to the reduction of £100,000, a retention of £75,000 and

a client loss claim of £50,000 agreed by Mr Hughes and Mr Seddon. The Company's annual turnover recorded in the November valuation was £719,774 before deductions for consultancy and client losses of £99,825 and £102,000 respectively, leaving recurring fees at £518,489. Mr Hughes and Mr Seddon agreed to progress the without prejudice staff buyout offer set out in the letter of 3 January 2018. Mr Hughes and Mr Seddon also agreed to award themselves discretionary payments in terms of Clause 9.1 of their service agreements. Mr Hughes was paid £50,000 through a consultancy company of his and £20,000 into a pension scheme for him. Mr Seddon received £10,000 and £20,000 into a pension scheme for him.

[10] On 8 March 2018 Mr Hughes and Mr Seddon again unanimously agreed to award themselves discretionary payments in terms of Clause 9.1 of their service agreements. Mr Hughes received £55,000 and Mr Seddon £30,000 to be paid when cash flow permitted. Their total salary for the same six month period from the date of the resignation of the petitioner to 31 March 2018 was £78,000 (£48,000 for Mr Hughes and £30,000 for Mr Seddon). On or around March 2018, the loan amount due to Mr Murphy (£82,000) was "re-allocated" to Mr Seddon, said to have been done on independent accounting advice. The company's accounts for 2018 stated that the balance due to the petitioner in respect of his director's loan was "in dispute". The director's loans of Mr Hughes and Mr Seddon are not said to be in dispute. There have been no payments to the petitioner from his director's loan account since 29 August 2018.

[11] Mr Hughes and Mr Seddon on behalf of the Company entered into the Sale Agreement with a company incorporated by the MBO team ("NewCo") on 3 April 2018 with a completion date the same day. This related to the accountancy business and certain assets of the Company, leaving other assets and liabilities with the Company. The same day the

Company changed its name to RAM 232 Limited and NewCo changed its name to Gerber Landa & Gee Limited. The purchase price was £594,000 including goodwill of £475,000 (which has subsequently been reduced to £350,000 due to retention and claims clauses inserted in the sale agreement), £118,000 of WIP and £1,000 of various other items. The petitioner was advised of the sale on 4 April 2018.

[12] On 12 April 2017 the directors of the Company had declared that an interim dividend of £70,000 would be paid to the shareholders as at that date. The petitioner was to receive the sum of £29,988 and received a tax voucher signed by Mr Hughes confirming this. This was not paid to the petitioner. On 9 May 2018 he demanded payment. No payment was received from the Company. Mr Hughes and Mr Seddon on behalf of the Company entered into a consultancy agreement with NewCo whereby the Company would receive £60,000 per annum from NewCo for the services of Mr Hughes and Mr Seddon as consultants. Mr Hughes and Mr Seddon on behalf of the Company also entered into a services agreement whereby the Company paid £40,000 per annum to NewCo for the provision of secretarial services, meeting room use, printing facilities and file storage facilities. Following the sale to NewCo the business of the Company consisted of the winding down of the work in progress and the consultancy services being carried out for NewCo. In December 2018, on behalf of the Company, Mr Hughes and Mr Seddon concluded that it did not owe the petitioner anything. They passed a resolution to charge the loan account of the petitioner with the goodwill which they allege was "eroded and/or taken by him personally" and that "[a]s an interim measure he had been debited with £231,454 which is the goodwill write down in the accounts to 31 March 2018." They further allege that the sum of £184,616.82 is due to the Company by the petitioner.

The alleged unfairly prejudicial conduct

[13] In brief terms, the matters said to constitute unfairly prejudicial conduct to the petitioner are as follows:

(i) exclusion of the petitioner from management and decision-making and conduct causing deterioration in the relationship between the directors prior to the petitioner's departure;

(ii) exclusion of the petitioner as a director;

(iii) re-allocation of £82,000 to Mr Seddon;

(iv) the grant of floating charges in favour of Mr Hughes and Mr Seddon;

(v) sale of the business to the MBO team at an undervalue and failing to give the petitioner any information about the sale to the MBO team;

(vi) receipt of excessive remuneration by Mr Hughes and Mr Seddon after the departure of the petitioner;

(vii) failure to pay dividends;

(viii) non-payment and debiting of the petitioner's loan account.

Evidence

[14] In the summary of the parties' submissions, set out below, reference is made to the key points of evidence founded upon by them. I also comment on the evidence in the section containing my decision and reasons. At this stage I simply identify the key witnesses led for each side and note some relevant headline points in their evidence, before commenting briefly on the differences in approach taken by the respective experts.

Factual witnesses

Petitioner

[15] The petitioner spoke to the various matters of background and the points said to constitute unfairly prejudicial conduct. He described his dealings with the first and second respondents, and Mr Murphy, in detail. He had known Mr Hughes personally since childhood and they had been in business together since 1969. There had been some disagreements and both of them were strong-willed. He had also known Mr Seddon for a lengthy period. He mentioned individuals who ran family businesses and had used his services as clients when he worked at the Company. After the petitioner's meeting with Mr Murphy, Mr Hughes had on several occasions asked the petitioner "What is it you are not telling us?", indicating to the petitioner a level of distrust. The petitioner accepted that in meeting Mr Murphy he did not do what Mr Thomson had advised and took a different view. He accepted that he told Mr Murphy that he would be prepared to pay £10,000 to him. It was correct that the collapse of Heather Capital had given rise to litigations, but not against the partnership or the Company. At no time had the petitioner acted in collusion with Mr Murphy. The petitioner had performed a reasonably substantial amount of his work remotely, from Australia, but that had not affected the income generated by his services. As a holder of 42% of the shares, he had no reason to seek to harm the Company, for example by clients leaving its business. The business was always a going concern. He said that Craig Butler, in carrying out the valuation and in agreeing with the offer put forward by the MBO team, had not been given access to the underlying workings of the firm and did not have proper regard to the unrecorded work-in-progress ("WIP") position. The amounts paid to Mr Hughes and Mr Seddon looked like a mechanism to remove the surplus bank funds built-up by the Company.

[16] Discussions about a MBO had been going on for some time. It was correct that after his departure twenty-nine clients had given mandates allowing him to advise them on a consultancy basis, but not on the accounting matters covered by the Company. He had given tax advice to a customer that had proved to be incorrect and a claim had been made against the Company resulting in a payment from the Company's insurers. He did not accept that the offer made by the MBO team on 3 January 2018 was a fair valuation. He could give no reason for calling into question the behavior of Craig Butler, a fellow accountancy professional, in relation to the valuation and the offer. Two of the MBO team were related to Mr Hughes (one being his wife and the other his son, from an earlier marriage) and so the family as a whole would benefit from a lower sale price. He accepted that no offer other than that made by the MBO team was made for the Company's business.

[17] A number of individuals who owned businesses which had been clients of the petitioner when he worked for the Company gave evidence. In broad terms he was a trusted professional accountancy advisor. The reasons for their businesses leaving the Company were given. The petitioner did not take on that type of business. Next, Mr Murphy gave evidence as to his involvement in the various issues summarised above.

Respondents

[18] Mr Hughes was the first witness led for the respondents. He explained the reason for forming the Company, that is the fallout from the Mathon affair. The business was transferred for £1.1m to the Company. It was correct that the former partners, now directors, did not anticipate that a director would exit but remain as a shareholder. Discussions about succession of the business had commenced in about 2014. It was correct that the last audit for Mathon had been in 2009. But risk was still a live issue in 2017. The

initial price suggested to the MBO team had been £1.2m. However, no price was agreed and they hadn't got down to the nitty-gritty. The relationship with the petitioner had deteriorated from 7 August 2017, following discussions about payments to Mr Murphy. Mr Hughes had kept saying "What is it you are not telling us?" to the petitioner because the petitioner had gone to see Mr Murphy against counsel's advice. It was quite unclear why the petitioner said he was going to pay the ICAS fine or penalty. Mr Hughes thought the petitioner was in cahoots with Mr Murphy, but accepted that he gone down a blind alley with that theory. The petitioner refused to agree to pay the bonus to Mr Seddon suggested by Mr Hughes. The reason for giving the special notice to remove the petitioner as a director was to try to get an explanation for his conduct. A long notice was given in the hope that discussions could take place. No decision to remove him had been reached. Mr Hughes did not view himself as bullying or domineering. After the petitioner left, and two major clients had gone and twenty-nine mandates had been issued, Mr Hughes spoke to a number of the clients who had used the petitioner when he was with the Company to see if they would remain, but they did not commit to doing so.

[19] Mr Hughes explained that Gordon Butler of Milne Craig had been asked to do a valuation in October 2017 but had declined because he was too close to the Company. His son, Craig Butler, carried out the valuations. He did not accept that Craig Butler's valuations were incorrect. The dividend due to the petitioner in April 2017 was credited to his loan account. He had never sued for payment. A number of legitimate claims should be set-off against his loan account. As a result, he currently owed the Company money. The salary and bonus payments received after the petitioner's departure were reasonable and not over-generous. Mr Hughes had made an offer to buy-out the shares of the petitioner for £150,000 shortly after the present action was raised.

[20] Mr Seddon then gave his testimony, broadly covering the background issues noted above. He also said that at the time of the special notice he had not made up his mind to vote in favour of the removal of the petitioner as a director. Thereafter, Craig Butler was called and explained his reasons for reaching the views he reached on valuation. He had been given no information about a possible sale price of £1.2m. Previous offers would not normally be asked for, as an objective approach was taken. He looked at it from the point of view of a buyer. The Company was not a happy ship. The sharp exit of the petitioner had impacted the client base. There was evidence that clients were leaving. The final reduction to £475,000 was appropriate as the business was toxic and it was difficult to imagine anyone being interested in buying it. In carrying out the valuation process he had spoken to a number of members of staff. He did not recall seeing a WIP balance. The WIP figure put to him in cross-examination, £997,000, would not have affected his valuation. From a buyer's point of view that would not have changed goodwill in the slightest.

[21] Evidence was then led from Lorna Gray, who had been part of the management team and took part in the MBO. She had never been formally advised that at the time of incorporation the goodwill of the Company had been valued at £1.1m. Mr Murphy's exit had created some uncertainty, although his clients stayed. She never agreed at any point to be part of an MBO team buying for £1.2m. There were obvious tensions before the petitioner's departure but she was not aware of a complete breakdown. The MBO team had carried out a detailed assessment based on various risk factors and came up with a figure of just over £500,000. After a further meeting around Christmas 2017, £475,000 was agreed as the offer. No external advice was sought. Some informal discussions took place between Mr Hughes in December 2017 and members of the MBO team. The offer was based on what the recurring fees moving forward would be. It was thought to be a fair price. There was no

conspiracy between Mr Hughes, Mr Seddon and the MBO team to get a soft-price undervaluing the business. There was no cosy deal.

[22] The final witness for the respondents was Gordon Butler, who had worked for Milne Craig. He had known the petitioner, Mr Hughes and Mr Seddon for many years. There were cross-referrals of clients between the two firms. There had been discussion in 2013 about the firms merging. If the MBO had not occurred, that being the first option, a merger may have taken place. He had become involved in discussions prior to the petitioner's departure, in an attempt to stop polarisation of the parties. A sudden break could result in clients being lost. He had no reason to think that his son would not do the valuation job objectively. He had no axe to grind and knew both Mr Hughes and the petitioner, but did not socialize with either of them. Mr Butler understood that in giving the special notice Mr Hughes did intend to remove the petitioner as a director.

Expert witnesses

[23] Mr David Bell, the expert led on behalf of the petitioner, prepared a valuation for the three dates requested, namely 30 September 2017 (the day before the petitioner's resignation), 3 April 2018 (the date of sale to the MBO team) and 31 March 2019 (the date when the present action was raised). In his supplementary report, he also gave a valuation for 31 October 2019, the final date used by the respondents' expert. He considered a valuation of the Company under both what he described as a common valuation method, that is the EBITDA multiple basis (Earnings Before Interest, Taxes, Depreciation and Amortisation, subject to an appropriate multiplier) and on a net asset basis. On 30 September 2017, the EBITDA valuation of the Company was £1,136,000 with the petitioner's shares being worth £487,000. On 3 April 2018, the EBITDA valuation was

£952,000 in total and £408,000 for the petitioner's shares. On 31 March 2019, the net asset valuation was £392,000 and the petitioner's share of the value at £168,000. On 31 October 2019, it was £216,000 and £93,000. Mr Bell considered the EBITDA basis to be a more appropriate method of valuation for the petitioner's shareholding at 30 September 2017 and 03 April 2018, due to the nature of the business and there being goodwill within the trade. The net assets basis was a more appropriate method of valuation for the final dates because the business is conducting limited trade and effectively winding down. In his opinion, a minority discount should not be applied to the value of the petitioner's shares in the Company, but should the court decide to apply a minority discount, a discount in the region of 20% to 25% would be an appropriate level of discount.

[24] Mr Robin McGregor, the respondents' expert on valuation, used the same dates for the first two valuations and used 31 October 2019 for the third one. He was of the view that it is unlikely that a company trading as a professional services business would be purchased as a share sale, due to the risk perceived by a buyer of latent liabilities. The particular circumstances of the history of the Company meant that a sale of its shares at each of the valuation dates would not have been possible. This was because any potential purchaser would not have been prepared to risk the liabilities that the Company had assumed when it purchased the business of the former firm of GLG in 2013. Accordingly, a sale of the Company would have to proceed as an asset sale. Similarly, there would be no realistic prospect of a sale of a minority shareholding in the Company, due to the nature of the business and the risks he outlined. The potential claims arise from the audit of Mathon and could be brought against GLG and/or the Company.

[25] Mr McGregor explained that when the business was transferred from GLG to the Company, the latter assumed all assets and liabilities. Consequently, any buyer would be

concerned about what potential liabilities may be linked to the Mathon audit and more widely to the principals directly involved in that work. Additionally, he considered that a purchaser might be concerned about possible future reputational risk arising from an association with the Mathon case. Further, in early 2017, Mr Murphy was found guilty of professional misconduct in relation to payments that had been made to members of his family from Mathon. In August 2017, the directors of the Company notified their insurers of an unquantified professional indemnity claim. Hence, Mr McGregor assumed that a sale was only likely to a trade-buyer and that such a purchaser would only acquire the business and assets, not the shares. Therefore, he considered that the appropriate basis for the valuation of the Company would be on a break-up or liquidation basis. In these circumstances, the value in the Company would be realised by the sale of its business and assets as a going concern, followed by an orderly wind-down to settle its liabilities, culminating in a distribution of capital to the shareholders.

[26] The conclusion reached by Mr McGregor on the value as at 30 September 2017, assuming the petitioner's co-operation, was £526,000 for the whole share capital and £225,000 for the petitioner's share of assets of 42.84%. The alternative basis, which assumed a lack of co-operation from the petitioner, concluded on a lower value for the whole share capital of £227,000 and of £97,000 for the petitioner's share at the same date. The valuation calculation recognised that the petitioner had not co-operated to maximise the value of the goodwill arising on a sale and had obtained mandates from some clients. As at 3 April 2018, the conclusion was a value for the whole share capital of £262,000 and of £112,000 for the petitioner's share. On 31 October 2019, the figures were £104,000 for the whole share capital and £44,000 for the petitioner's share. As the valuation was on a break-up basis, no issue of

discount arose but if the court was minded to find that a sale of shares was more likely, a minority discount of 33% to 50% would be appropriate.

[27] The experts met prior to the proof and discussed a wide range of issues. Among the central points raised, Mr McGregor was of the view that the EBITDA approach was only suitable for larger accountancy practices, best suited to mature and stable businesses, which was not the case here. Mr Bell disagreed with that view. Mr Bell pointed out that the three prior valuations by Milne Craig had been carried out on an adjusted profits basis.
Mr McGregor did not view that approach as appropriate. Mr McGregor also considered the EBITDA multiplier used by Mr Bell to be too high, but Mr Bell viewed it as the appropriate multiplier.

Statutory provisions

[28] Section 994 of the 2006 Act provides:

> “(1) A member of a company may apply to the court by petition for an order under this Part on the ground -
>
> that the company’s affairs are being or have been conducted in a manner that is unfairly prejudicial to the interests of the members generally or of some part of its members (including at least himself), or
>
> that an actual or proposed act or omission of the company (including an act or omission on its behalf) is or would be so prejudicial.
> …
>
> Section 996 of the 2006 Act further provides:
>
> “(1) If the court is satisfied that a petition under this Part is well founded, it may make such order as it thinks fit for giving relief in respect of the matters complained of.
>
> (2) Without prejudice to the generality of subsection (1), the court’s order may –
> regulate the conduct of the company’s affairs in the future; require the company -
> to refrain from doing or continuing an act complained of, or
> to do an act that the petitioner has complained it has omitted to do;

…
(e) provide for the purchase of the shares of any members of the company by other members or by the company itself and, in the case of a purchase by the company itself, the reduction of the company's capital accordingly."

Submissions

[29] The court had the benefit of full and detailed written submissions, followed by oral submissions, for the petitioner and the respondents. These have been taken fully into account. There was extensive citation of authority, and when I come to set out my decision and reasons I shall refer to the key legal principles relied upon. At this stage, I give a brief summary of the main points made.

Submissions for the petitioner

[30] This case involved a quasi-partnership. There was an informal understanding or arrangement among the incorporators, which was not reflected in the articles, that the petitioner, and indeed all the incorporators, would be involved in the management of the Company and be a director. The informal understanding included that nugatory salaries would be paid, and the Company would pay dividends when it could afford to do so. Prior to the petitioner's exit from the Company, dividends would regularly be paid by a credit to each of the member's loan accounts. The parties understood and accepted that on an exit, each of them would no longer participate as a member and should have their share value returned, over a period of five years unless more than one member was leaving in which case the period would be extended.

[31] Contrary to his legitimate expectations, the petitioner was unfairly excluded from the management of the Company from around April 2017. This was also contrary to the

expectations of the parties agreed between them at the time of incorporation such that each of the directors would participate in the management of the Company, as they had when the business was operated under the auspices of the previous partnership structure. Between April and September 2017, contrary to the agreement between the parties, Mr Hughes failed to engage openly and constructively with the petitioner, levelled false and accusatory allegations at him, refused to pay dividends in accordance with established policy and sought to award Mr Seddon substantial bonus payments.

[32] The petitioner offered to meet Mr Hughes, but he declined that offer and then proceeded to serve the special notice. Mr Hughes says he took legal advice, so service of the notice may have been lawful but it was unfair. The notice of a resolution to remove the petitioner as a director on 21 September 2017 was without justification and contrary to the interests of the Company, and contrary to the petitioner's legitimate expectations. On the evidence of Gordon Butler, Mr Hughes had determined to remove the petitioner as a director. While a minority shareholder can be deprived of relief if the unfairly prejudicial conduct he has suffered can be justified, or rendered not unfair, by the minority's own conduct, there was no basis for that view here. There were insufficient grounds to justify the petitioner's exclusion based on the meeting with Mr Murphy. There was no advice from counsel that a director was not to meet with Mr Murphy. No adverse consequences flowed from that meeting. The trust and confidence having irretrievably broken down between the founding members, and the petitioner considering that he had no other choice in the matter, he resigned.

[33] Thereafter, with the petitioner so excluded, and in the absence of an offer to purchase the petitioner's shares, Mr Hughes and Mr Seddon took steps which unfairly caused prejudice to the petitioner or contributed to same. They did the following: (i) refused to pay

dividends when distributable reserves were available which was contrary to the legitimate expectations of the petitioner, in particular in respect of financial year 2018 but also subsequent to the sale of the business to the management buy-out team; (ii) granted floating charges in favour of themselves, to secure indebtedness owed by the Company to each of the members pursuant to the Minute of Agreement dated November 2013; (iii) re-allocated to Mr Seddon the sum of £82,000 (which was otherwise intended to be split between the shareholder's loan accounts equally or alternatively would be attributed to the Company's reserves) to the exclusive benefit of the Mr Seddon; (iv) sold the business at undervalue to the MBO team, without any or any adequate notice to the petitioner, and on terms which defied objective commercial criteria, without informing the petitioner or giving him the opportunity to provide information which would have improved the terms of the sale; (v) failed to provide the petitioner with information in respect of the sale in a timeous or comprehensive fashion, hiding behind confidentiality provisions which were ultimately waived; (vi) paid themselves excessive remuneration in the form of bonus and pension payments in the period following the petitioner's exit; (vii) ceased the payment of the petitioner's loan accounts, approximately one year after his exit, both contrary to agreed and established practice and in breach of the Minute of Agreement; (viii) threatened to and ultimately did debit the petitioner's loan account unlawfully with arbitrary, illiquid, and unquantified sums which had not been the subject of independent assessment or inquiry.

[34] In relation to the sale of the assets to the MBO team, there was no attempt to sell on the open market. Other accountancy firms were potential buyers but were not approached. Craig Butler valued the goodwill and was not provided with details of the work in progress. There was no evidence that the petitioner ever sought to persuade clients to leave, which would in any event have been against his interests. The exclusion of the petitioner from any

information or involvement prior to the sale breached the informal understanding and agreements entered into by the members on incorporation. The price paid for the sale to the MBO team was not a fair price. It did not reflect the value of the Company. The petitioner was not consulted on the salaries paid to the remaining directors. He was not paid any dividend. The bonuses paid to the directors in 2018 and their basic salaries from April 2018 were unfairly prejudicial to the petitioner. Considered objectively these were excessive. Both experts agreed that annual remuneration for a director of the Company (prior to sale of the business) at £100,000 per director was reasonable.

[35] Mr Bell took the proper approach to valuation of the petitioner's shares. He approached the valuation with consistency and integrity, patently mindful of his duty to the court. His approach was transparent, vouched and cross checked, and based on the Company's trading performance. There were various problems with Mr McGregor's approach and if his views were accepted adjustment to the sums identified were needed. It would be appropriate to value the business as at 30 September 2017, or alternatively at 3 April 2018. As a matter of fact and law, no discount should be applied. The assertion on behalf of the respondents that Mr Bell has failed to act as an independent expert witness and that his evidence should not be regarded as admissible was wholly lacking in substance.

[36] The respondents' concession that the case involved a quasi-partnership was important. Even though the petitioner could demonstrate loss, that wasn't needed and in a quasi-partnership a breakdown in trust will give a right of relief. The respondents asserted that they were following legal advice but that was not sufficient as an answer. With a history of unfair prejudice, the court should give a remedy that is commensurate with the value that was lost. The offer to buy the petitioner's shares, made after the action was raised, was not for a fair value. Regard should also be had to the evidence of Lorna Gray

that after the sale of the business consultancy arrangements were entered into with the respondents.

Submissions for the respondents

[37] The respondents did not take issue with the proposition that the Company was established as a quasi- partnership. However, the petitioner had not made out his pleaded case, either in relation to the existence of unfairly prejudicial conduct or in relation to the relief sought. The petitioner had not established any unfairly prejudicial conduct on the part of the respondents prior to 1 October 2017 when the petitioner's resignation as a director took effect. In particular, in view of the petitioner's admitted conduct in his dealings with Mr Murphy following the receipt of advice from Mr Thomson, service of a special notice on 26 September 2017 in relation to the petitioner's removal as a director did not amount to unfairly prejudicial conduct. The Minute of Agreement relied upon by the petitioner did not preclude removal of a director.

[38] Further, the petitioner had not established any unfairly prejudicial conduct on the part of the respondents after his resignation took effect on 1 October 2017. In particular, the decisions taken by the respondents in relation to the sale of the Company's business after that date were commercial decisions properly taken by the respondents on the basis of professional advice, in difficult circumstances which had been brought about by the sudden resignation of the petitioner. The unchallenged evidence before the court was that the management buy-out was the "only show in town" and that the sale price achieved was reasonable.

[39] The evidence did not support any exclusion of the petitioner from the management of the Company. He was able fully to participate up until his resignation as a director, at

which point he chose to remove himself from involvement in the management of the Company. There was, in any event, no legitimate expectation or other sort of agreement that a shareholder that had resigned as a director of the Company would be entitled to remain involved in its management. Asking a colleague and friend of decades to address concerns as to what he was up to (particularly in circumstances when he is holding meetings with a former director contrary to the decided position of the board of the Company) did not amount to unfairly prejudicial conduct, even if such questions were posed in a brusque fashion.

[40] In the period prior to the resignation of the petitioner, there was no refusal to pay dividends in accordance with any established policy. First, the petitioner has not proved that there was any established (far less binding) policy in relation to the payment of dividends. Second, the evidence was that the decision not to pay a dividend in 2017 was one taken on commercial grounds and considered and approved by the board of the Company. Intimation of the resolution to remove the petitioner as a director was not unfairly prejudicial (particularly in light of the circumstances which led to its intimation). The document was served in accordance with the Company's constitutive documents and legal advice. There was no bargain or understanding in place (far less proved in the evidence) that directors could not be removed. Indeed, the acknowledged events which took place in relation to Mr Murphy showed plainly that shareholders could properly be removed from their role as directors. In cross-examination, the petitioner made a number of significant concessions in relation to what occurred in relation to Mr Murphy. In short, the agreement was that they wouldn't pay Mr Murphy and it would be left to see how he reacted, that is, there would be no meetings with him. In any event, the notice of removal was never voted upon and the petitioner's case must rest upon its mere intimation.

[41] In breach of his fiduciary duties, the petitioner had forwarded emails to a client of the Company concerning private business of the Company. As the petitioner acknowledged in cross-examination, the advisory services he provided to clients of the Company in his private capacity after his resignation were services which would have been provided by the Company had it not been for his resignation, with the result that he and not the Company obtained income from their provision. The petitioner had departed suddenly, without putting in place any planning for his departure, his two most significant clients had removed their business and the petitioner had sent mandates for business of twenty-nine clients. Inevitably, these actions on the part of the petitioner significantly drove down the value that could reasonably be achieved for the business that was sold. There was no exclusion from the management of the Company; he had chosen to leave his role as director, bringing his involvement in the management of the Company to an end by that act. He was given notice of any AGM or EGM of the Company and could attend as a shareholder.

[42] The petitioner had failed to establish any entitlement to payment of a dividend for the period to 31 March 2017. Further, there was no prejudicial conduct after the resignation in relation to the refusal to pay dividends. This was a matter for the board of the Company. There was no evidence before the court to the effect that they did not act in accordance with their view of the commercial interests of the Company. The grant of floating charges in respect of the obligations owed to Mr Hughes and Mr Seddon has not given rise to any prejudice to the petitioner. The reallocation of the sum of £82,000 to Mr Seddon was a commercial decision taken by the board of the company to reflect his contribution to the business in the exercise of the discretion of the board.

[43] There was no evidence before the court that the business sold to the MBO team was sold at an undervalue. That argument ran contrary to the contemporary advice of Craig

Butler and the position of the MBO team itself (as spoken to by Lorna Gray). No contrary material was before the court. There was no failure on the part of the respondents to provide information in relation to the sale to the petitioner. The petitioner had absented himself from the business. It was a matter for the board to take forward the sale of part of the business. Also, there was no evidence before the court that any remuneration (by way of bonus or pension payments) has been excessive. That assertion was rejected by Mr Hughes and Mr Seddon in their evidence. No contradictory evidence was advanced on behalf of the petitioner.

[44] There was no unfair prejudice in stopping the payments in respect of the petitioner's loan account or in applying contra-charges. In light of the events following the petitioner's resignation, the board of the Company reached the proper commercial view that it did not accept that any further payments were in fact due. The petitioner had taken no step to constitute any debt that might be due by way of the loan account (either in this action or other legal proceedings). Following immediately upon the commencement of these proceedings, an offer to purchase the shares of the petitioner at a price of £125,000 (subsequently increased to £150,000) was made by Mr Hughes. Those offers were rejected by the petitioner.

[45] If the petitioner is entitled to relief, the appropriate date for valuation of his shares would be the date of the court's order, which failing 3 April 2018. In any event, the petitioner has failed to establish the valuations of the company, and therefore of his shares, as at each of the dates proposed by him. The evidence of Mr Bell was inadmissible or, at the very least, unreliable. He failed to act as an independent expert witness, to the standards set out in *Kennedy* v *Cordia Services Limited* 2016 SC (UKSC) 59 (at paragraphs [52] and [53]). His evidence as to the choice of valuation methodology and the appropriate EBITDA multiplier

was, in essence and as he himself accepted, merely his say-so. Moreover, he had no contemporary, real world valuation experience. He was unable to explain with any clarity the nature of any historic experience which he may have had (more than five years ago). Even then, his valuation work took place in the particular context of his role as a forensic accountant. He gave the clear impression of using an earnings-based methodology because that was within what he perceived to be his comfort zone, when other methods would not have been. It is also to be noted that he accepted throughout his evidence under cross-examination that the approach of Mr McGregor to the issues in dispute was wholly appropriate for a professionally competent valuer. The evidence of Mr McGregor should be preferred to that of David Bell in relation to the valuation of the company at each of the various dates which were discussed.

Decision and reasons

Factual witnesses

[46] Each side raised some points about the factual evidence led by the other. In my view, no issues of any substance as to credibility or indeed reliability arose in the evidence. The parties broadly accepted the key factual matters, with no stark disagreement, the points of difference in the main being more nuanced and to do with why particular conduct took place rather than whether it occurred.

Expert witnesses

[47] I reject the submission for the respondents that the evidence of the petitioner's expert, David Bell, is inadmissible or unreliable. In my view, he did not fail to meet the standards set out in *Kennedy v Cordia Services Limited.* He obviously offered opinion

evidence, but it was not, as suggested, "merely his say-so". Rather than being unsubstantiated *ipse dixit,* it was based upon quite standard features of the EBITDA approach. He did have, in my view, appropriate experience. The EBITDA technique can of course be difficult to apply without readily available comparators or factors allowing precision, given the specific factual circumstances of the particular company. He explained, with reasons, why the EBITDA approach for valuation on the first two dates was to be preferred. However, the criticisms are also of no moment because, as I explain below, it is the valuation on the final date, where there was limited disagreement between the experts, which is relevant.

Unfair prejudice

[48] The court was supplied with what was appropriately described by senior counsel for the respondents as "an electronic library of the authorities" on the matter of unfairly prejudicial conduct and the appropriate remedies. Rather than setting out these extremely extensive citations in any detail, I refer to the central principles of relevance to the issues raised in the present case in my reasoning below.

General principles

[49] The key principles applicable to the court's task in identifying unfairly prejudicial conduct of a company's affairs are summarised by Lord Hoffman in the decision of the House of Lords in *O'Neill* v *Phillips* [1999] 1 WLR 1092 and by the Court of Appeal in *Grace* v *Biagioli* [2006] 2 BCLC 70 (*per* Patten J at para [61]). The petitioner requires to establish, assessed on an objective basis, that the acts or omissions complained about relate to the management of the affairs of the company, caused prejudice to the petitioner's interests as a

member and that the prejudice is unfair (see also *Bovey Hotel Ventures Ltd, Re* unreported 31 July 1981; *RA Noble & Sons (Clothing) Ltd, Re* [1983] BCLC 273; *Saul D Harrison, Re* [1995] 1 BCLC 14; *Guidezone Ltd, Re* [2000] 2 BCLC 321). Unfairness and prejudice are both required and establishing only one of these will not suffice: *Jesner* v *Jarrad Properties Ltd* 1993 S.C. 34; 1994 SLT 83; *Rock (Nominees) Ltd* v *RCO (Holdings) Plc (In Members Voluntary Liquidation)* [2004] EWCA Civ 118; [2004] BCC 466; [2004] 1 BCLC 439. The objective test is whether a reasonable bystander observing the consequences of the conduct, would regard it as having unfairly prejudiced the petitioner's interests. A member of a company will be entitled to complain of unfairness where there has been some breach of the terms on which he agreed that the affairs of the company should be conducted, or where the rules have been used in a manner that equity would regard as contrary to good faith: *O'Neill* v *Phillips* [1999], at 1099; *Re Phoenix Office Supplies Limited* [2003] 1 BCLC 76, at 85h; *Wilson v Jaymarke Estates Limited and others* 2006 SCLR 510, at para [10]. As Lord Hoffman explained in *O'Neill* v *Phillips*, compliance with equitable considerations is a more appropriate articulation of the concept than the expression "legitimate expectations". Within a quasi-partnership, a court may give effect to informal agreements and understandings which have been relied upon even if they would not otherwise have binding legal force (see eg *Re Guidezone Ltd,* at para [17]; *In Re Hart Investment Holdings Ltd* [2013] EWHC 2067, at para [38]).

The petitioner's heads of claim for unfair prejudice

(i) <u>*Exclusion of the petitioner from management and decision-making and conduct causing deterioration in the relationship between the directors, prior to the petitioner's departure*</u>

[50] The respondents accepted that the Company was a quasi-partnership company, thus falling within the species of private company described by Lord Wilberforce in *Re*

Westbourne Galleries Ltd [1973] AC 360. The Company here was one in which shareholders, who could have run the business as a partnership, preferred the form of a private company to be managed by all of them. In a quasi-partnership, understandings or arrangements about the future management of the company commonly exist between the members. In the present case, Mr Hughes and Mr Seddon accepted that it was understood that each of the former partners would be involved in the management of the company. Exclusion from management can cover taking decisions in secret or not informing the petitioner: *Robertson Petitioner (No 1)* 2010 SLT 143. A petitioner may have a justifiable complaint, even if no longer involved in day-to-day management, of not being told of matters which have, or could have, a fundamental effect on the company.

[51] The petitioner's contention that Mr Hughes and Mr Seddon excluded him from management and decision-making from around April 2017, up to his resignation as a director, is not well-founded. No specific management matters or decisions which involved exclusion of the petitioner were identified. Moreover, there were accepted examples of his involvement in the Company's affairs, such as attending a board meeting, taking an active part in the processing of the final accounts for the year ending 31 March 2017, issuing instructions for counsel's advice in relation to the situation with Mr Murphy and attending a consultation in that regard on 4 August 2017, and making a request for a board meeting in September 2017 accompanied by proposed items for inclusion in the agenda. The petitioner was not excluded from the decision reached after being told of the desire by Mr Hughes to pay Mr Seddon a bonus. Indeed, the petitioner's views on that issue prevailed. The fact that Mr Hughes put forward that proposal was, of itself, neither unfair nor prejudicial. Exclusion from management prior to the petitioner's departure from the Company is not made out.

[52] There was undoubtedly a deterioration in the relations between the petitioner and Mr Hughes and Mr Seddon, on various matter but particularly in relation to dealing with Mr Murphy's situation. The petitioner made a number of concessions in cross-examination about his meeting with Mr Murphy, broadly to the effect that the advice of counsel (to "wait and see") which the directors agreed to, was not followed by him and that he had gone back on what was agreed at the meeting with counsel on 4 August 2017. When he met with Mr Murphy (on 1 September 2017) to explain why Mr Murphy's loan repayments were being stopped, in addition to seeking to broker a settlement between Mr Murphy and the Company, he mentioned the possibility of making a payment to Mr Murphy out of his own pocket. It was what occurred at this meeting that caused Mr Hughes to ask, and over-time more than once, "What is it you are not telling us?". While I accept that this question can imply an element of distrust, one can also at the same time appreciate that, against the fraught and tense background of the Mathon situation, which remained a concern for the board, this unexplained meeting and offer had happened and Mr Hughes was unable to understand why these things had been done. There had already been a finding of professional misconduct by ICAS on 30 May 2017 in respect of Mr Murphy. He had caused the Company to become involved in assisting with an ongoing criminal investigation and there were continuing queries to the Company from the bankruptcy trustee of the key player in Heather Capital. The Company's professional indemnity insurers were on notice of a potential claim against the Company because of its position as auditor of Mathon and Bathon. Substantial claims against other professionals had also been made by Heather Capital. In these circumstances, the concerns of Mr Hughes, manifested in his question, are entirely understandable and do not meet the test for unfairly prejudicial conduct.

[53] The mere fact of a deterioration in their relationship does not suffice. It is not enough to found a petition for relief in respect of unfairly prejudicial conduct just to show that the trust and confidence between members of a quasi-partnership company have broken down, regardless of whether that breakdown can be said to be the result of the conduct of the respondent (*McKee* v *O'Reilly* [2003] EWHC 2008 (Ch); [2004] 2 BCLC 145, at [54], under reference to *O'Neill* v *Phillips per* Lord Hoffman at 1104F-1105B). In a quasi-partnership context where there is an implied understanding that each person will act in good faith and if there is conduct which breaches that standard, that may, on the facts, be unfair. Equally, the destruction of trust and confidence could arguably be prejudicial. But the breakdown of trust and confidence must flow from, or amount to, unfairly prejudicial conduct. Accordingly, while conduct that destroys trust and confidence between the member and those controlling the company can constitute unfair prejudice, I do not consider the conduct of Mr Hughes at this stage to be unfairly prejudicial. In any event, if a shareholder led those controlling the company to act in the manner complained of, that may affect whether the conduct is unfair and here there was conduct by the petitioner which gave rise to the questions asked by Mr Hughes.

(ii) *Exclusion of the petitioner as a director*

[54] As is obvious, a single act or omission may be sufficient for unfair prejudice to result and for a petition to succeed (see eg *Re Marchday Group plc* [1998] BCC 800, at 816). The conduct may only be proposed or be in contemplation, or something which is sought to be done: *Re Kenyon Swansea Ltd* (1987) 3 BCC 259 at 264; see also *Whyte, Petr* 1984 SLT 330; *Petr Thomas Orr and anr in re D S Orr & Sons (Holdings) Limited* [2013] CSOH 116, at para 39. Various decisions show that where a member in a quasi-partnership is formally or

informally excluded from the management of the company, this will form grounds for relief, when it was agreed or understood that he would remain involved and his conduct did not justify taking that step. If his conduct did justify such a step, there will be no unfair prejudice in his exclusion or removal as a director: *Re Sprintroom Ltd* [2019] BCC 1031, at paras [82]-[83]; *Badyal* v *Badyal Paramount Powders (UK) Ltd* [2018] EWHC 68 (Ch), at para [154].

[55] By email dated 21 September 2017, Mr Hughes advised the petitioner that a special notice had been received on that day proposing the removal of the petitioner as a director. Consideration of that special notice formed part of the agenda for the board meeting the following day. The minutes of that meeting recorded that the special notice had been received from Mr Hughes, stating his intention to propose the following ordinary resolution at the next general meeting of the company:

> "That Charles Martin be and is hereby removed from the office as director of the company."

The minutes recorded that it was resolved that a general meeting be arranged and that the resolution be proposed to the members of the company. The meeting would take place no earlier than 28 days from that date. Whether or not it is true that Mr Hughes and Mr Seddon were actually seeking to give the petitioner time to consider and discuss the position (which in respect of Mr Hughes does not fit with the evidence of Gordon Butler) the fact is that a simple and clear message of an intention to remove the petitioner as director was given. Moreover, the petitioner offered to meet with Mr Hughes before the notice was issued and that offer was declined. No qualifications to that intention to remove were ever passed on to the petitioner. The evidence was that legal advice was obtained resulting in the notice being served, but the existence of such advice does not exclude unfair prejudice being

the result. The petitioner did not attend the board meeting, but there was no indication that if he had attended the decision reached would not have been passed. Against the background of tense and fraught exchanges and correspondence, which of themselves did not cause unfair prejudice, this apparently clear next step of removal of the petitioner from his position as director went too far. In the context of this quasi-partnership, it amounted to unfairly prejudicial conduct. Its unfairness is made out, firstly, because it proposed to breach the understanding or arrangement that the former partners would be directors (unless they left) and, secondly, the notice was not based upon any specific breach of any fiduciary or other duty by the petitioner. Rather, it was said in the evidence to be an attempt to flush out the reasons why the petitioner had discussed matters with Mr Murphy and made the proposal to make a personal payment. The need for further discussion about such an issue did not require the extreme measure of a notice of removal, especially when the petitioner had previously offered to meet up for discussions.

[56] The point made on behalf of the respondents that the petitioner had acted in breach of fiduciary duty is, in my view, a red herring; that formed no basis for the proposed removal. The respondents' position that on 8 and 9 September 2017 the petitioner had forwarded emails relating to private Company business to a client of the Company played no part in influencing any of the conduct relied upon by the parties at the material time. The notice of removal was also prejudicial for the simple reason that the petitioner being told by the two remaining former partners and now directors that they intended to remove him from his position as director plainly had a negative impact on the petitioner.

[57] But the problem for the petitioner is that the prejudice ends there, because ultimately the actual cause of the petitioner's exclusion (better put, his withdrawal) was his own choice and decision to resign. In his witness statement, the petitioner explained that from around

April 2017 his relationship with the other directors, primarily Mr Hughes, started to deteriorate. He states that the distrust and accusations from Mr Hughes coupled with the notice to remove the petitioner "and the cumulative stress of the months prior to this" led to his resignation. While resignation may not have actively been under consideration prior to the special notice, it is clear from the petitioner's evidence that a range of factors caused it to occur. Serving the notice no doubt contributed to the breakdown in relations, but these were already strained by that stage. The special notice was never implemented and, on the evidence, it might not have been implemented. Removal was clearly threatened, in an unfairly prejudicial manner, but it was not inevitably the outcome. While Gordon Butler spoke of the desire of Mr Hughes to remove the petitioner, Mr Seddon was, on his own evidence, not fully committed to that approach. It cannot be said that there was no option other than to resign. Among other things, the petitioner could have waited for the outcome, or if need be sought an interim interdict preventing his removal. As is obvious and made clear in the articles of association, resignation causes a person to cease to be a director. It was that act, and not the respondents' conduct, which resulted in the petitioner ceasing to be a director. While some prejudice resulted from the proposed removal, the central matter relied upon by the petitioner (exclusion from management) did not.

[58] I should add that I see no force in the submission for the petitioner that the parties understood and accepted that on an exit, each of them would no longer participate as a member and should have their share value returned, over a period of five years. That was plainly the position in the Minute of Agreement, but there was no suggestion by the petitioner at the time of his exit or indeed afterwards that this part of the agreement had to be complied with. The petitioner is not relying upon that; if he was to do so the unfair

prejudice would presumably have been to refuse to pay him that portion of the share value which by now he should have received.

(iii) *Re-allocation of £82,000 to Mr Seddon*

[59] There is an arguable basis that the re-allocation of this sum to Mr Seddon could be regarded as prejudicial to the petitioner, in that it was not split between the shareholders' loan accounts equally or attributed to the Company's reserves, and Mr Seddon could instead have been given a bonus or salary increase. However, this conduct cannot be viewed as unfair to the petitioner. No basis for any agreement or understanding that such a payment could not be made was presented. While the payment created a benefit to one of the remaining directors, it did not benefit the other. It was a decision reached on a commercial basis, by the board of the company, to reflect Mr Seddon's contribution to the business. This was a matter for the discretion of the board.

(iv) *The grant of floating charges in favour of Mr Hughes and Mr Seddon;*

[60] I do not accept the petitioner's submission that the grant of floating charges in respect of the obligations owed to Mr Hughes and Mr Seddon constitutes unfairly prejudicial conduct. It was not unfair. The petitioner could readily have moved, at for example an AGM, for a floating charge in his own favour but did not do so. In any event, whether at the time or at any point thereafter it has not resulted in any prejudice to the petitioner.

(v) <u>Sale of the business to the MBO team at an undervalue and failing to give the petitioner any information about the sale to the MBO team</u>

[61] In considering this allegation, it is of major importance to have regard to the background to the sale to the MBO team. It had been under consideration for quite some time. There was an initial reference to the goodwill of the Company being valued in the region of £1.2m. But the October 2017 valuation (£710,000) and the November 2017 valuation (£545,000) carried out by Craig Butler reached much lower figures, with the first of these being, on Craig Butler's evidence, a draft valuation. The petitioner had resigned shortly prior to these dates and that gave rise to a number of events. He informed clients of the Company, including in particular Slater Menswear and Samuel Kingsley, of his resignation. These two major clients left the business of the Company. He provided consultancy services to twenty-nine clients. These were services that could have been provided by the Company and hence their loss could potentially reduce its income. In December 2017 two senior staff took voluntary redundancy, linked to the departure of clients who had used the services of the petitioner and those who worked with him. Craig Butler explained the factors which he took into account, including the above and of course the ongoing concerns about the Mathon matter. Whether or not in his witness statement his use of the word "toxic" was because his father, and Mr Hughes, had earlier used that term, he adhered to that view in his oral evidence. The MBO team carried out its own assessment, as Lorna Gray explained, and came up with their offer of £475,000 for the goodwill of the business. Mr Hughes asked for advice from Milne Craig on this offer and Craig Butler advised that it was not unreasonable. He explained in his evidence why he took that position. The submissions for the petitioner stopped short of any allegation that Craig Butler had somehow acted unfairly or unreasonably in arriving at his views. The

focus for the petitioner's allegations came to be on non-inclusion of WIP figures and to a lesser extent the valuation of assets.

[62] I regard the evidence of Craig Butler as entirely credible and reliable, and indeed persuasive as to the reasonableness of the MBO team's offer. There was no suggestion of any other offer being available or indeed of any sound basis for the price being unfair. It is of course correct that relatives of Mr Hughes (his son, born during the previous marriage, and his second wife) formed part of the MBO team. But there was no serious contention that this somehow affected the reasonableness of the price. Indeed, Mr Seddon agreed to the sale price, thus applying it to his own share of business, and no relatives or associates of his were in the MBO team. The conclusion, which I consider to be firmly supported, is that an independent professional adviser advised the respondents that the price offered by the MBO team was not unreasonable and he had sound, indeed good, reasons for reaching that view. I therefore reject the contention that the sale of the business to the MBO team was in any way a matter of unfair prejudice.

[63] However, the exclusion of a continuing shareholder in this quasi-partnership company, against the background of the parties' understanding, from any involvement whatsoever in relation to a proposed sale of the business was in my view unfair. As a long-standing and founding member of the business, with a substantial shareholding, he plainly had an interest in a sale. While keeping the Company's affairs confidential was arguably a factor, the petitioner could nonetheless have been advised of relevant matters and given an opportunity to comment or contribute to the discussion. But there remains a need to show prejudice. There is no doubt that he was prejudiced in a very general sense by not having information and not being able to participate in any way in the discussions about the sale, but at the same time there was nothing in the evidence to point towards his comments or

contributions, had they been obtained, having any impact on the proposed transaction. For example, there is nothing to suggest that an enhanced sale price from the MBO team, or from a different purchaser, could have been achieved as a result of involving him. In short, the sale would have gone ahead in any event and at the same price. Accordingly, there is no real prejudice arising from the denial of his involvement.

(vi) *Receipt of excessive remuneration by Mr Hughes and Mr Seddon after the departure of the petitioner*

[64] The relevant legal principles in relation to remuneration in private companies are set out and explained in *Irving* v *Irving (No.1)* [2007] 1 BCLC 349, *per* Blackburne J, at paras [267]-[270]. In some circumstances, a person who has ceased to be a director may be able to argue that directors' remuneration, where there is no payment of dividends to the shareholders, is excessive. This could arise when, for example, the remuneration does not reflect a reasonable payment for their contributions and in effect includes sums which ought to have been paid as dividends. Reliance on established practices in relation to payments made by the company whilst all parties were involved in management of the company is inappropriate after one of the directors resigns: *Wilson* v *Jaymarke Estates Ltd and anr.* In the present case the Minute of Agreement in fact lays out the intended position, which is that the person who leaves as a director will have his shares bought out and paid for (in the circumstances of a single departure from directorship) over a five year period. There is simply nothing to support the view that there was any informal agreement or understanding that a person who resigned as a director must receive a dividend. The petitioner made no suggestion that the remaining directors had fixed their remuneration in disregard of the provisions of the articles of association governing that matter. In fact, the

proper procedures for fixing the directors' remuneration were followed. This matter is a commercial decision by the board. Excessive remuneration by the respondent to himself from company funds controlled by him can amount to unfairly prejudicial conduct to the petitioner: *Fowler* v *Gruber* [2009] CSOH 36, *per* Lord Menzies, at para [132]. But in order for the remuneration to be excessive, it would have to have been fixed not by reference to objective commercial criteria and not within the bracket that directors carrying the responsibility and discharging the duties in the particular company would expect to receive. The fundamental problem for the petitioner is the absence of any proper evidential basis that the amounts paid were excessive and unreasonable. It is correct that the expert witnesses identified particular sums for the purposes of their assessments on valuation, but no specific focus on the reasonableness of the sums paid, having regard to the profits of the enterprise, was put before the court. This ground must therefore fail.

(vii) *Failure to pay dividends*

[65] Unfair prejudice may be established where the payment of dividends, when justified by the company's financial position, was part of the agreed or understood basis on which the petitioner became a member of the company and where there is no justification for not paying dividends. But the fact that a minority shareholder is part of a quasi-partnership company does not of itself establish such an agreed or understood basis and no other ground for it was advanced. Fixing dividends is a commercial decision. Even if a broad expectation of dividends being payable arose from their previous conduct, there were sound commercial reasons for retaining the funds to which the respondents had regard, including the potential requirement to fund a defence and counterclaim should Mr Murphy bring proceedings.

[66] For the petitioner to be able to show that non-payment of dividend (apart from the non-payment of the dividend declared in April 2017, discussed below) to amount to unfairly prejudicial conduct he would require to show either that (i) the directors failed in their duty under section 172 of the Companies Act 2006; (ii) there was an understanding or arrangement, express or implied, that where a person resigned as a director he would continue to receive a dividend; (iii) the sums paid to the directors by way of remuneration or bonuses were excessive. None of these points is made out. I therefore reject the defender's contention that a failure to pay dividends, such as requested by the petitioner in August 2017, was unfairly prejudicial.

[67] However, the failure of the directors to pay the dividend declared on 12 April 2017, which was payable contemporaneously and demanded by the petitioner to be paid on 12 May 2018, was unfairly prejudicial. It is correct that the previous practice had been for such due dividends to be allocated to the individual's loan account. But there was no clear arrangement or understanding to that effect and I was shown no basis for rejection of a member's request for payment of a due dividend rather than having it put into his loan account.

(viii) *Non-payment and debiting of the petitioner's loan account*

[68] The fact that the first and second respondents ceased the payment of the petitioner's loan account, approximately one year after his exit, was unfairly prejudicial. Doing so was contrary to the understanding of the shareholders and established practice and inconsistent with the Minute of Agreement. No convincing ground for viewing this conduct as not being unfair and prejudicial was made out. Given that this is a quasi-partnership and the

arrangements between the shareholders, nothing turns on the fact that the loan account was payable in his capacity as a director.

[69] As narrated above in relation to the factual background, the first and second respondents (as the board) threatened to and ultimately did debit the petitioner's loan account. They gave reasons for doing so. However, on the evidence led no clear and substantiated basis for making these debits was established. Indeed, the respondents did not seek to establish such a basis on any detailed and vouched grounds but instead suggested that this was an ongoing dispute that required to be resolved by other means. In the absence of any proper ground for the debits, I regard the conduct as unlawful but even if not, then it was certainly unfair. The sums debited were not the subject of any independent assessment or inquiry. It was also plainly prejudicial as the petitioner no longer received payments from his loan account. No doubt if the respondents do have a proper basis for debiting the loan account and their claim that the petitioner owes money to the Company, they can seek to recoup any sums by whatever means is appropriate.

Conclusion on heads of claim on unfair prejudice

[70] Accordingly, I conclude that to a limited extent the petitioner's assertions of unfairly prejudicial conduct are made out. In particular, the unfairly prejudicial conduct comprised the service of the special notice (albeit that the resulting prejudice was restricted), non-payment of the dividend declared in April 2017, cessation of payments on his loan account and debiting of his loan account.

Remedies

[71] In putting right, or curing, the consequences of unfairly prejudicial conduct the court has a wide discretion to do what is just and equitable: s 996 of the 2006 Act; *Re Bird Precision Bellows*. However, the normal remedy, and the most practicable and equitable, is to have the petitioner's shares purchased at a fair value by the respondents or the company. A price based on a pro-rata valuation is more likely (*Profinance Trust SA* v *Gladstone* and see also *In re Bird Precision Ltd*, at 430D) particularly where the company is a quasi-partnership: *CVC/ Opportunity Equity Partners Ltd* v *Demarco Almeida* [2002] 2 BCLC 108, at para [41]).

[72] The overriding requirement is that the valuation should be fair on the facts of the particular case (*London School of Electronics, Re* [1986] Ch 211). Where unfair prejudice has been established, the court is obliged to consider the whole range of possible remedies and choose the one which, on an assessment of the current state of relations between the parties, is most likely to remedy the unfair prejudice and deal fairly with the situation which has occurred (*Grace* v *Biagioli*, at para [73]). There is no single appropriate method to be applied to any valuation. Rather, the appropriate basis for valuation will depend upon the whole facts and circumstances of the particular case, with the court requiring to make a choice that is fair to all the parties.

[73] The choice of the date at which shares are to be valued for the purposes of a buy-out order is a matter for the exercise of the discretion of the trial judge (*Re Cumana Ltd* [1986] BCLC 430, at 436b-436c; *Re Elgindata Ltd* [1991] BCLC 959), but the overriding requirement is that the date of valuation should be fair on the facts of the particular case (*Profinance Trust SA* v *Gladstone*, at para [60]). The date should be that which best remedies the unfair prejudice held to be established: *Re Abbington Hotel Ltd* [2011] EWHC 635 (Ch); [2012] 1 BCLC 410. The starting point should be that *prima facie* an interest in a going concern ought

to be valued at the date on which it is ordered to be purchased. However, there are many cases where fairness to one side or the other requires the court to take a different date. But a petitioner is not entitled to a "one-way bet", and the court will not direct an early valuation date simply to give the petitioner the most advantageous exit from the company, especially where severe prejudice has not been made out: *Profinance Trust SA* v *Gladstone.* The remedy is to be proportionate to the unfair prejudice suffered *Re Edwardian Group Ltd* [2018] EWHC 1715 (Ch), [2019] 1 BCLC 171.

[74] The experts on valuation each gave reasonably sound and clear evidence. The central difference is that for the first two valuation dates Mr Bell used the EBITDA approach using a multiplier, thus valuing the business as a going concern and Mr McGregor used a net-assets approach. Mr Bell's evidence in relation to the first two dates of valuation was less persuasive than that of Mr McGregor. While Mr Bell made some reference to other share transactions, there was a lack of appropriately comparable financial data which supported the approach to the EBITDA valuation for an accountancy-service company of this size. The potential impact of the departure of key clients was not, in my view, fully recognised. While there is some evidential support for the view that the financial performance of the Company was not in the short-term affected by the departure of the petitioner, regard must be had to the longer-term consequences. Mr McGregor gave proper weight to the highly significant issue about the potential impact upon the company resulting from the Mathon affair.

[75] However, the valuations on those first two dates are not relevant. The problem here is that these two dates (the date of resignation and the date of sale of the business) were not points in time when the respondents' conduct had caused any sufficiently serious unfair prejudice. It is really the accumulation of the acts over the whole period of time, including

the non-payment and debiting of the loan account which occurred after the dates mentioned, that gives rise to the unfair prejudice of the kind that merits a remedy. There is no earlier point in time after which further damage to the financial position of the Company arose because of the unfair prejudice, which, if it had occurred, might have caused that point in time to be appropriate. The sale of the Company's business and assets to the MBO team clearly changed the Company's position, but payment for that sale was received and there was no unfair prejudice to the petitioner from that transaction.

[76] Taking the third date (31 October 2019), Mr Bell quite properly adopted the net-asset approach. To all intents and purposes this was the same method as the break-up valuation used by Mr McGregor, except that Mr McGregor made certain adjustments. Prior to those adjustments, for each expert the net-asset value was £216,000. An item in the management accounts described as "the goodwill adjustment suspense", amounting to £47,000 was treated by Mr McGregor as a provision of funds and hence was deducted. Mr Bell was not clear as to why that position was reached and indeed no evidence supporting the deduction was provided. Mr McGregor also deducted £40,000 in contingent liabilities in relation to the office lease. As Mr Bell notes, the purchaser remains in the property and continues to meet the costs of the property. No sufficient basis for that further deduction was advanced. The final deduction by Mr McGregor is £25,000 for dissolution costs. Mr Bell considered that due to the directors' professional backgrounds they would look to mitigate and minimise these costs wherever possible, but this point was not developed further. I shall therefore take £216,000 as the starting point, deducting only the £25,000 for dissolution costs. This results in a net asset value of £191,000, meaning that the value of Mr Martin's 42.84% shareholding at the final date given is, rounded up, £82,000.

[77] Based upon the authorities, I therefore conclude that the appropriate date for fixing a price for the purchase of the petitioner's shares is that final date. That is the date which best remedies the unfair prejudice established. While some of the unfairly prejudicial conduct occurred earlier, I have had regard to the cumulative effect of it including the ongoing matters concerning the petitioner's loan account. In light of my findings above, there is no ground for going back to the date of the petitioner's departure from the Company or the date of the MBO for the purposes of valuation. I also conclude that it is not appropriate, in this quasi-partnership case, to apply a discount.

[78] For completeness, I observe that early in these proceedings Mr Hughes made an offer to purchase the petitioner's shares for £125,000, subsequently increased to £150,000. But it was not suggested that this offer included the expenses incurred by the petitioner nor, more importantly, that it met the criteria in *O'Neill* v *Phillips*. There was no independent valuation behind the offer and it was not suggested that at that point the petitioner was afforded full access to the Company's records and other relevant information to allow him to form a view or receive expert advice on the point. Moreover, the figure offered apparently included sums already owed to the petitioner in his loan account.

Disposal

[79] I shall therefore make an order for the purchase of the petitioner's shares in the sum of £82,000. I shall also grant orders for payment to the petitioner of £16,856 in respect of his director's loan account and £29,988 in respect of the interim dividend for the period to 31 March 2018. However, the question of whether it is Mr Hughes and Mr Seddon, or the Company, who should be ordained to make the particular payments requires to be

addressed and I will fix a by-order hearing to deal with this matter. In the meantime, I reserve all questions of expenses.