Lawyer sees broader scope in ruling

By GRANT CAMERON

A court ruling has shed more light on the types of evidence that can be used to determine fair value of a minority shareholder's stake in a company, says a lawyer who was involved in the case.

David Hobbs, of Hobbs Giroday Barristers and Solicitors in Vancouver, says the judge in the case accepted an assortment of evidence beyond the traditional reports of chartered business valuators. "This case shows that you can look at other things as well. In this case, the court went beyond valuation reports and looked at the extraneous evidence. To me, that's what's significant about it."

The case was heard in the British Columbia Supreme Court by Justice Anne MacKenzie and pitted petitioner Antonio Monachese against Tri Phi Holdings Ltd. and other respondents. Monachese had a 25 per cent interest in a company that owned the Jingle Pot Pub in Nanaimo, B.C., while Tri Phi and the respondents owned a majority of the shares. Hobbs was counsel for Tri Phi Holdings.

The case began in September 2004 with a hearing over a petition from Monachese. The court granted a consent order that provided for the sale of Monachese's shares to Tri Phi, subject to adjudication of their fair value.

The case got complicated, though, when a dispute arose over the true value of Monachese's shares as of Sept. 30, 2004.

Monachese argued the shares were worth between $293,500 and $449,250 while Tri Phi indicated they were worth $79,171 to $86,181. Both sides had business valuators backing their claims.

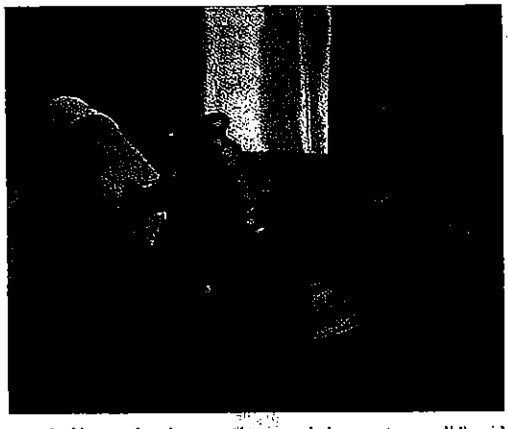
Court heard the pub was acquired in 1992 for $1.1 million but after 2002 earnings of the business were adversely affected by smoking restrictions and changes to the liquor licensing system. Two of the majority shareholders also had health problems, which raised concerns about how long their shares would be held.

Court also heard that in April 2004 the majority shareholders contributed another $210,000 to the business in order to comply with a requirement from the Royal Bank to pay down debt and reduce the mortgage. Monachese had been asked to contribute $50,000 of that figure but he refused.

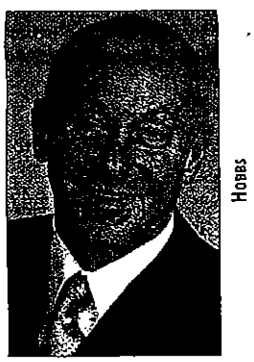
As a result, more shares were issued to the majority shareholders and Monachese's stake was reduced to six per cent. In spite of the contribution, Monachese claimed he still owned a quarter of the business.

Tri Phi and the other respondents had argued that the total value of all shares was $344,723 on Sept. 30, 2004, which the judge accepted.

In 2007, the judge ruled that Monachese's equity in the company had been reduced as a result of the cash injection and the valuation of $86,181 put forward by Tri Phi was not only fair but generous.



Additionally, the judge noted that in establishing share values, Monachese's business valuator predicted a future income for the pub that was unreasonably high, and selected too low a capitalization rate to be applied to the future income of the business, and further that the valuator double-counted certain excess lands.



HOBBS

The judge also said the valuator failed to reduce the assets to account for the 2004 equity contribution and didn't include potential income taxes that would be incurred upon the sale of shares in future by the respondents.

Hobbs said the decision is important to accountants and other professionals because the judge considered evidence put forward by Tri Phi and other respondents that is traditionally not part of the strict framework of the valuation concept.

For example, he said, the judge considered such things as the refusal by Monachese to inject additional capital into the business venture as well as the existence of a shortened future investment holding period, based on the advanced age and poor health of one of the majority shareholders.

"Valuation was the main piece of evidence but it was some of the other pieces of evidence that influenced the court as well," said Hobbs.

"When you look closely at the case, you can see that there were some pieces of evidence that were looked at that helped the court decide what the value was for the shares. It had nothing to do with the valuation report per se, it was the pieces of evidence.

"It was common sense observations that went to value as opposed to just using the formula that valuators use."

"Traditionally a judge would just use a chartered business valuator and whatever their opinions were they'd just pick one opinion over the other."

David Hobbs, Hobbs Giroday

Judges traditionally rely on reports from business valuators to determine the value of a shareholder's interests, but the judge's decision showed other factors can help to sway the courts, said Hobbs.

"Traditionally a judge would just use a chartered business valuator and whatever their opinions were they'd just pick one opinion over the other. I think there's just a bit more of an open door as to what you can look at to determine fair value and this case has got some examples of that type of evidence."

The British Columbia Court of Appeal has provided some direction with respect to the approach that should be used to determine fair value of the shares of a company.

In a case involving Cyprus Anvil Mining Corp., the court stated that finding the fair value of a stock is a special problem i every instance and defies bein reduced to a set or rules fo selecting a method of valuation, o to a formula or equation whicl will produce an answer with th illusion of mathematical certainty.

The court stated that each cas must be examined on its own fact that each represents its own diffi culties, and that no method o determining value which migh provide guidance should b rejected.

Hobbs said the Monachese cas was discussed at a conference c chartered business valuators and i the most recent legal example c determining value of shares.

"There haven't been man cases since Cyprus Anvil wher there's been much extrapolation o the law," said Hobbs. "This cas just gives you some examples o different things that you migh look at."