

Monachese v. Tri Phi Holdings Ltd.

Between
Antonio Monachese, Petitioner, and
Tri Phi Holdings Ltd., Earle Phillips, Brian
Phillips, Lance Phillips, 2211 Holdings Ltd., M.P.M.
Holdings Ltd. and Jingle Pot Pub Ltd., Respondents

[2007] B.C.J. No. 1285
2007 BCSC 846
157 A.C.W.S. (3d) 963
New Westminster Registry No. S84347

British Columbia Supreme Court
New Westminster, British Columbia
MacKenzie J.

Heard: September 15, 2004; May 30, 2005; November
23, 2006; and April 12, 2007 (New Westminster)
And March 22 and May 31, 2007 (Vancouver).
Judgment: June 12, 2007.
(83 paras.)

Corporations and associations law — Corporations — Shareholders — Rights — Sale of shares — Shares — Valuation — Determination of the fair value of shares held by the petitioner — The petitioner held a 25 per cent interest in a pub business — A consent order provided for the sale of his shares to the respondent, subject to the adjudication of their fair value — The court accepted the respondent's valuation — The valuator clearly explained his methodology and reasoning, which was internally consistent — The respondent's valuator concisely disposed of any questions that arose from the critique of his report by the petitioner's valuator.

Determination of the fair value of shares held by the petitioner, Monachese — The petitioner held shares in the respondent, 2211 Holdings — In 1992, the shareholdings represented a 25 per cent ownership interest in a pub, the respondent Jingle Pot Pub — The pub was acquired by the respondent, Phillips, in 1992 for \$1.1 million — Further investments occurred in 2004 when the financing bank requested the reduction of other indebtedness — The petitioner refused to make a further equity contribution — At that time, his shares were valued at \$210,000 — The pub's earnings diminished following the implementation of smoking restrictions — In addition, Phillips' age and health raised concerns regarding the long-term horizons of the pub — A consent order provided for sale of the petitioner's shares to Phillips' family holding company, the respondent, Tri Phi Holdings, upon adjudication of their fair value as at the time of the order — The petitioner contended that the shares were worth between \$293,500 and \$449,250 — The respondent submitted that the proper range of valuation was between \$79,171 and \$86,181 — HELD: The fair value of the shares was \$86,181 — The petitioner's valuator selected an

unreasonably high predicted future income for the pub — The petitioner's valuator selected too low a capitalization rate to be applied to the predicted future income — The petitioner's valuation of the real estate holdings double counted certain excess lands and failed to include latent tax liabilities — The petitioner's valuation further failed to reduce the assets to account for the 2004 equity contribution — Finally, the petitioner's valuation failed to include potential income taxes that would be incurred by 2211 Holdings upon the sale of the shares — The respondent's valuation was reliable, coherent and reasonable — The respondent's valuator clearly explained his methodology and reasoning, which was internally consistent — The respondent's valuator concisely disposed of any questions that arose from the critique of his report by the petitioner's valuator.

Counsel:

Counsel for the Petitioner: Allan W. Watchorn.

Counsel for the Respondents: David A. Hobbs, I. Giroday.

MacKENZIE J.:—

Introduction

¶ 1 A petition brought by the dissident minority shareholder came on for hearing on September 15, 2004. That day, on the consent of the parties, I granted an order intended to resolve the petition and the unhappy differences between the parties.

¶ 2 The order of September 15, 2004 provides that the 250 Class A common voting shares (the "Shares") issued by the Respondent, 2211 Holdings Ltd. ("2211 Holdings") and registered in the name of the Petitioner, Antonio Monachese, be sold to the Respondent, Tri Phi Holdings Ltd. ("Tri Phi"), at fair value (without any minority shareholder discount) as at September 30, 2004.

¶ 3 The order provided for:

- (a) A schedule by which Tri Phi and the Petitioner provide to each other and to me all opinions and other affidavit evidence they relied upon to support their submissions as to the fair value of the Shares, and for the exchange of written submissions;
- (b) Thereafter, the parties would be at liberty to seek leave to make final oral or written submissions or to waive the need for such submissions before I adjudicated upon the fair value of the Shares;
- (c) Upon my adjudicating the fair value, the time for the filing of an appeal of the order passing, and so long as a stay of proceedings had not been granted, Tri Phi was ordered to forthwith pay the Petitioner the fair value ordered for the Shares and the Petitioner was ordered to deliver them to Tri Phi and execute all documents necessary to effect full transfer, free and clear of all charges and encumbrances;
- (d) The Petitioner to also forthwith execute and deliver such documentation as

may be required to resign as an officer and director for any of the Respondent corporations in which the Petitioner holds such offices or directorships; and

- (e) Upon payment for and transfer of the Shares, the Petition would stand as dismissed as if dismissed after a full trial on its merits without costs payable to any party.

The issue

¶ 4 The issue is this: what is the fair value of the Petitioner's Shares as at September 30, 2004?

¶ 5 The Petitioner, relying on his valuator, Mr. Symes, says it is in the revised range of \$293,500 to \$449,250.

¶ 6 On the other hand, Tri Phi says it falls in the range of \$79,171 to \$86,181, based on the opinion of its business valuator, Mr. Barbour.

¶ 7 For the reasons that follow, I prefer the valuation provided by Mr. Barbour for the Respondents. I find the fair value of the Petitioner's shares as at September 30, 2004, to be \$86,181.

The Background

¶ 8 I find the facts set out by the Respondents in their submissions to be supported by the affidavit evidence and relevant. I accept, and have largely reproduced, those facts here.

¶ 9 In 1992, the Respondent, Earle Phillips, purchased a pub at 2211 Jingle Pot Road in Nanaimo, British Columbia, for approximately \$1.1 million. To finance it, Mr. Phillips borrowed about \$1 million from the Royal Bank and added \$150,000 of his own by a shareholder's loan. The pub was renamed the Jingle Pot Pub.

¶ 10 The ownership structure of the Jingle Pot Pub after acquisition in 1992 was that 2211 Holdings acted as the holding company. 2211 Holdings owns all the issued shares of the Respondents, Jingle Pot Pub Ltd. ("JPPL") and M.P.M. Holdings Ltd. ("MPMHL"). I will refer to these three corporations collectively as the "Jingle Pot Group". JPPL holds the liquor licenses and inventory, operates the Jingle Pot Pub and, more recently, the liquor store. MPMHL holds the hard assets, namely the lands, building and furniture at 2211 Jingle Pot Road. MPMHL is the landlord and JPPL is the sole tenant.

¶ 11 The shareholders in 2211 Holdings have changed somewhat since the Jingle Pot Pub was purchased in 1992. The shareholders as at April 5, 2004, and their respective shares were:

Tri Phi Holdings Ltd.	500 Class A common voting shares;
Brian Phillips	250 Class A common voting shares;

Antonio Monachese 250 Class A common voting
shares;

TOTAL: 1,000 Class A common voting shares.

¶ 12 The Royal Bank holds a mortgage charging 2211 Jingle Pot Road. It came up for renewal around September 2003.

¶ 13 In late 2003 and early 2004, the Royal Bank required a reduction in the MPMHL loan. Following its demand, Earle Phillips asked the Petitioner to contribute \$50,000 equity based on his 25% interest in the Jingle Pot Group, to be added to \$100,000 from Tri Phi and \$50,000 from Brian Phillips (the three shareholders of 2211 Holdings) to cover the \$200,000 reduction required by the Royal Bank. The Petitioner refused.

¶ 14 On April 6, 2004, two of the three shareholders of 2211 Holdings, Tri Phi and Brian Phillips, contributed \$210,000 to 2211 Holdings and were issued 3,500 common shares between them as consideration. The \$210,000 was used to partially repay the inter-company debt owing by 2211 Holdings to MPMHL. In turn, MPMHL used the \$210,000 to repay a portion of the Royal Bank debt.

¶ 15 The result of issuing further shares in 2211 Holdings to Tri Phi and Brian Phillips was that Mr. Monachese's interest in 2211 Holdings at September 30, 2004 was approximately 6%. Despite this, the Petitioner's shareholdings as at September 30, 2004 were valued by Mr. Barbour as if the issuing of the shares on April 6, 2004 as consideration for the injection of \$210,000 had not occurred. As a result, Mr. Monachese is assumed to hold a 25% interest in 2211 Holdings for the purposes of Mr. Barbour's valuation.

¶ 16 The Jingle Pot Pub is near the inland edge of Nanaimo. It is therefore a destination pub and must attract customers to travel to the Pub by way of entertainment, lower food prices and food specials. The Jingle Pot Pub has traditionally used lower food prices and food specials to gain customers and sales.

¶ 17 Around 2002, the provincial government changed the liquor licensing system and brought in smoking restrictions. These changes have negatively affected liquor and food sales in pubs, and reduced the earnings of JPPL.

¶ 18 On August 30, 2005, Earle Phillips was 73, and his health had been poor the year before. His doctors advised him to slow down. Given his age and health, Mr. Phillips planned to hold his investment in 2211 Holdings (through Tri Phi) for no more than two or three years. Brian Phillips, manager of the Pub and liquor store and the other shareholder in 2211 Holdings, has had heart problems which creates risk and concern about the long term investment horizon of the shareholders in 2211 Holdings and, therefore, in the Jingle Pot Group.

¶ 19 Tri Phi is Earle Phillips' family's holding company. Tri Phi controls five subsidiary companies. Tri Phi has used an investment strategy of restricting ownership in active businesses to a 50% interest in order to maximize the number of low income tax rate pools available to it. For the purpose of Mr. Barbour's valuation, Tri Phi holds 50% of the shares of 2211 Holdings. In fact, since April 6, 2004, Tri Phi has held more than 50% of the shares of 2211. Therefore, and

because it is to purchase the Petitioner's shares pursuant to the Court Order of September 15, 2004, Tri Phi will not enjoy the small business deduction tax rate. This may have adverse tax consequences to the overall Tri Phi group.

¶ 20 Mr. Barbour was retained to provide an opinion of the fair value of a 25% share holding in 2211 Holdings as at September 30, 2004. He prepared a Comprehensive Valuation Report dated August 8, 2005. His opinion is contingent upon a series of assumptions that are found in that Report. Mr. Phillips has read Mr. Barbour's Report, including the factual assumptions listed, and has deposed that they are true to the best of his knowledge, information and belief.

Mr. Barbour's Determination of Fair Value

¶ 21 The parties agree that the essence of the distinction between "fair market value" and "fair value" is that there is no minority discount applied in determining a "fair value".

¶ 22 Mr. Barbour valued the shares of 2211 Holdings as if the issuance of shares on April 6, 2004, to the other shareholders for consideration of \$210,000 had not occurred. Thus, the Petitioner's shares constitute 25% of the total shareholding.

¶ 23 Mr. Barbour's opinion is that the fair market value of 100% of the shares of 2211 Holdings as at September 30, 2004, is \$344,723 and the fair value of the Petitioner's shares should be calculated based upon a 25% pro-rata value, being \$86,181. This is based upon an assumption that the future investment holding period by Tri Phi in 2211 Holdings is five years and that the latent income tax implications relating to assumed dispositions should be discounted by 38%.

¶ 24 Mr. Barbour provides an alternative valuation based upon an assumption that Tri Phi's future investment holding period is only three years and the discount rate for latent income tax implications is 25%. In that alternative, the fair market value of 100% of the shares of 2211 Holdings is \$318,866 and 25% thereof is \$79,171.

¶ 25 In terms of valuation methodology, Mr. Barbour maintained a separation of the investment in the real estate (through MPMHL) from that of the pub/liquor store operations (through JPPL). This is an unconsolidated or unintegrated valuation methodology.

¶ 26 In his valuation, Mr. Barbour included calculations relating to the potential income taxes which will be incurred by Tri Phi if the shares (of JPPL) or the assets (of MPMHL) are sold in the future. This discount is based upon Earle Phillips' age and health and the estimated period of time Tri Phi would hold the Jingle Pot Group from the September 30, 2004 valuation date. Mr. Brian Phillips' health is also a concern. Mr. Barbour assumed that a reasonable holding period from September 30, 2004 was five years or alternatively three years, taking into account Mr. Earle Phillips' pronounced intention to hold the Jingle Pot Group investment for two to three years only.

¶ 27 In calculating the fair value of 2211 Holdings' shares, Mr. Barbour used a value determined by reference to higher tax rates. He sets out his rationale for doing so in his Report.

(a) Mr. Barbour's Valuation of Jingle Pot Pub Ltd.

¶ 28 Mr. Barbour separated the redundant assets from the operating assets of JPPL as reflected in its balance sheet as at September 30, 2004 to determine a net book value of \$94,672. He provides this analysis in his Report.

¶ 29 Mr. Barbour's analysis of the statements of income for JPPL for the years ended April 30, 2001 through 2004 and for the interim five month periods for September 30, 2003 and 2004 are set out in his Report. He noted that the recorded expenses he listed must be adjusted for valuation purposes as there is some distortion in the expenses caused by tax and financial planning. Mr. Barbour made four adjustments to the reported expenses, being:

- a. an adjustment for purchase of capital assets in the amount of \$17,000 per year;
- b. a reduction in management salaries to \$60,000 per year;
- c. a reduction from actual rent of \$120,000 per year to \$81,700 per year based upon fair market rent; and
- d. an adjustment to normalize the legal and accounting fees at \$21,000 for the years 2004 and subsequent years.

¶ 30 Mr. Barbour made a series of calculations using different methodologies to calculate the expected pre-tax cash flow based upon historical cash flow. He concluded that the range of expected annual future income is between \$85,000 and \$128,000.

¶ 31 Mr. Barbour made a series of calculations in which he estimated the after-tax cash flow and then converted that after-tax cash flow into an estimated going concern value. He used an estimated rate of return which an investor would require for an investment of this type as having a range of 12 to 15% on after-tax income. Mr. Barbour calculated a going concern value of \$477,000, from which he deducted the redundant assets of \$13,068 to arrive at an estimated fair market value for the shares of JPPL in the amount of \$463,932.

(b) Mr. Barbour's Valuation of the Shares of MPMHL

¶ 32 As the primary business purpose of MPMHL is to hold real estate, Mr. Barbour says that the correct valuation methodology is to review the balance sheet and to make adjustments to reflect the fair market value of MPMHL's assets and liabilities. Mr. Barbour relied upon the real estate appraisal of October 4, 2004, prepared by Isle West Appraisals Ltd. which provides an appraised value of the land and buildings of \$864,000.

¶ 33 Mr. Barbour assumed that the depreciated value of the furniture and fixtures as recorded on the financial statements as \$1,806 at April 30, 2004 reflects their fair market value.

¶ 34 In early April 2004, MPMHL paid, as required, the \$210,000 reduction of the debt it owed the Royal Bank, so MPMHL's equity in the property reflected in the April 30, 2004 balance sheet is greater by \$210,000 than it otherwise would be. This debt reduction was achieved by the 2211 Holdings shareholders, Tri Phi and Brian Phillips, paying it to 2211 Holdings for consideration of further issuance of shares and 2211 Holdings reducing an inter-corporate debt owed to MPMHL by \$210,000. Mr. Barbour reasoned that as he was asked to

value the Petitioner's interest in 2211 Holdings as if the additional shares to Tri Phi and Brian Phillips had not been issued, the effects of the additional \$210,000 must also be adjusted for and he undid that payment for the purpose of his valuation.

¶ 35 Mr. Barbour next estimated the taxes on the sale of MPMHL's capital assets based on a five year holding period from the valuation date and discounted the estimated costs and taxes by 38% to arrive at a net value.

¶ 36 After making all the adjustments to MPMHL's balance sheet of April 30, 2004, Mr. Barbour concluded that the fair market value of the shares in MPMHL is \$602,480.

(c) Mr. Barbour's Estimated Value of the Shares of 2211 Holdings Ltd.

¶ 37 Mr. Barbour provided an analysis of the balance sheet of 2211 Holdings according to the financial statements of March 31, 2004.

¶ 38 Mr. Barbour makes adjustments to 2211 Holdings' investments in JPPL and MPMHL as recorded in the financial statements to reflect his calculations as to the value of JPPL and MPMHL noted above. He then made an adjustment based on his calculation of the estimated income tax liabilities which would be incurred on the disposition of the assets of 2211 Holdings. Mr. Barbour assumed that a sale of the shares of JPPL and a sale of the assets of MPMHL, with the resulting funds being distributed by MPMHL to 2211 Holdings, would be the logical method for 2211 Holdings to realize on those investments. Mr. Barbour calculated the total estimated income tax liability and, based upon an assumption that 2211 Holdings will hold the investment in the Jingle Pot Group for a further five years before disposing of it, determined a discount of the tax liability of 38%.

¶ 39 Mr. Barbour also reconciled the inter-company balances and accounts for the net effect of several inter-company transactions. The result is an estimated fair market value of 100% of the shares in 2211 Holdings of \$344,723.00.

¶ 40 To calculate the Petitioner's 25% interest, Mr. Barbour simply took 25% of the \$344,723 fair market value of 100% of the shares to arrive at \$86,181. He noted that if an alternative discount rate is used for the income taxes based on a three year holding period rather than a five year holding period, the fair market value of 100% of the shares is \$318,866 and the Petitioner's 25% share is \$79,717.

Mr. Symes' Critique of the Barbour Report of August 8, 2005 and Mr. Barbour's Response

¶ 41 In a short report dated May 31, 2006, Mr. Symes critiques Mr. Barbour's Report of August 8, 2005. The more substantive critiques and Mr. Barbour's responses are summarized below.

¶ 42 Mr. Symes' first substantive criticism is that Mr. Barbour assumes that the assets of MPMHL will be sold. Mr. Symes' view is that a liquidation of MPMHL's assets will not produce the "highest price available" per the Canadian Institute of Chartered Business Valuators' ("CICBV") definition of "fair market value" as opposed to a sale of MPMHL's shares, which will not involve real estate commissions and taxes. I accept Mr. Barbour's response that Mr. Symes is citing a definition of "fair market value" that is old. Since June, 2001 the definition

recommended by the CICBV is that in the Barbour Report. Mr. Barbour refers to the authoritative text, The Canada Valuation Service, to explain his choice of valuation methodology, a modified liquidation approach, for MPMHL.

¶ 43 On Mr. Symes' criticism that the liquidation of the assets of MPMHL will not produce the highest price available and, from the vendor's perspective, a deduction of taxes (which need not necessarily be incurred) would not be an act of prudence, I am well persuaded by Mr. Barbour's response to accept Mr. Barbour's choice of valuation. His response to Mr. Symes' complaint is that regardless of the definition of "fair market value" used, fair market value and fair value are to be determined as between a vendor and a purchaser, and not by the highest price that a vendor would like to receive. Mr. Barbour's view is that a potential purchaser of a corporation's small piece of real estate would prefer to purchase the asset rather than the shares of the vendor to avoid any liabilities the vendor company has and the expense of due diligence, which may not necessarily be fruitful, to determine if there are any such liabilities. This is supported by the "comparables" cited by Mr. William Gossett of Collier's in his report dated December 11, 2005. Of the eight comparables cited by Mr. Gossett, six involved asset sales and two involved share sales.

¶ 44 I also accept Mr. Barbour's explanation that even if a purchaser wanted to buy shares rather than the assets, the purchaser would nonetheless want to include all or a portion of the recognition of the latent income taxes that exist if the land and buildings were sold in the future. If a purchaser of the shares failed to do so, the purchaser would absorb all the potential latent income taxes and so would be penalized in the future if the assets were sold.

¶ 45 Mr. Symes' next substantive criticism of Mr. Barbour's August 8, 2005, Report is that the health of Earle Phillips is not relevant to the sale of the Petitioner's shares in 2211 Holdings, which is the subject of Mr. Barbour's valuation. Mr. Barbour responds and I agree that Mr. Symes has confused the concept of latent taxes at the corporate level of MPMHL, which would be triggered by the sale of the assets of MPMHL at a future date, with potential personal income taxes to be paid by the Petitioner on the sale of his shares in 2211 Holdings. The potential personal income taxes to be paid by the Petitioner on the sale of his shares in 2211 Holdings are not relevant to either determining the fair value of the Petitioner's shares or calculating the underlying potential income taxes relating to real estate held by MPMHL. I find it perfectly logical for a prospective purchaser of shares to contemplate latent taxes payable by that purchaser when the purchaser plans to divest itself of the investment. In the case of Tri Phi, the end of the investment period in the Jingle Pot Group is likely to be in the next few years based on Earle Phillips' age and health and the health of the manager of the Jingle Pot Pub operation, Mr. Brian Phillips.

¶ 46 Mr. Symes' next substantive critique of Mr. Barbour's report is that Mr. Barbour uses a high tax rate in calculating the income tax on the estimated future cash flow to be earned by JPPL. Mr. Symes says there would be many potential purchasers of JPPL's shares who would value the shares and the business using lower tax rates, which would increase the after-tax cash flow and the fair market value of JPPL. Mr. Barbour's response is that generally accepted valuation principles require that the low tax rate is not to be considered generally available to a notional purchaser. If the valuator wants to develop a theory that potential purchasers would be able to use the low tax rate, generally accepted valuation principles require that these "special

purchasers" be specifically identified or rationalized. Again, Mr. Barbour's response to Mr. Symes is persuasive and credible.

¶ 47 Also, I agree with Mr. Barbour's reasoning that Tri Phi is the court ordered purchaser and the low tax rate will not be available to Tri Phi. To value the shares using a tax rate not available to Tri Phi is to penalize that company. As stated in *Cyprus Anvil Mining Corp. v. Dickson* (1986), 33 D.L.R. (4th) 641 at 652 (B.C.C.A.), in determining fair value, each case must be examined on its own facts. In these circumstances, including a court order that a minority discount may not be applied and that Tri Phi will be the purchaser, the concept of fair value should include consideration of the tax rates actually available to Tri Phi.

¶ 48 Mr. Symes questions Mr. Barbour's ability to be an independent expert in light of his having prepared a report estimating the fair value of the Petitioner's shares in 2211 Holdings in December, 2003. Mr. Symes cites that earlier report with respect to Mr. Barbour's comment on whether to deduct tax costs.

¶ 49 With respect to his independence, Mr. Barbour notes that he is not aware of any professional standard of the CICBV or otherwise which suggests that, as a result of preparing a preliminary calculation in an "Advisory Report," he was in a conflict by subsequently developing a full Comprehensive Valuation Report. Mr. Barbour does not believe that his independence was adversely influenced by acquiring further information and spending time to develop his Report of August 8, 2005. I am not at all persuaded that Mr. Barbour is not an independent valuator here. Mr Symes' critique on this issue is unsupported and not persuasive.

¶ 50 With respect to the deductions for latent income taxes, Mr. Barbour points out that he provided alternative calculations in his Advisory Report of December 18, 2003, one being a 100% deduction and the other being a 50% deduction. Mr. Barbour stated in that report, "it is common to discount those costs by, say, 50% in the anticipation that the costs will not be incurred until some time in the future." In Mr. Barbour's August 8, 2005 Report, he applied a 38% discount of the income taxes, based upon his rationale developed in the full Comprehensive Valuation Report.

The Test

¶ 51 The British Columbia Court of Appeal has provided direction to the courts of British Columbia with respect to the approach to determining a fair value of the shares of a company. In *Cyprus Anvil Mining Corp. v. Dickson*, the Court was considering section 199(14) of the *Canada Business Corporations Act*, S.C. 1974 - 75 - 76, c. 33, where the court is required to "fix a fair value" for the shares of dissenting shareholders that are compulsorily acquired on a takeover offer. Lambert J.A., after citing and analyzing a number of American authorities, stated at 652-653:

It is not necessary for me to analyze those cases or to quote from them. The point that they emphasize is that the problem of finding fair value of stock is a special problem in every particular instance. It defies being reduced to a set of rules for selecting a method of valuation, or to a formula or equation which will produce an answer with the illusion of mathematical certainty. Each case must be examined on its own facts, and each presents its own difficulties. Factors which

may be critically important in one case may be meaningless in another. Calculations which may be accurate guides for one stock may be entirely flawed when applied to another stock.

The one true rule is to consider all the evidence that might be helpful and to consider the particular factors in the particular case, and to exercise the best judgment that can be brought to bear on all the evidence and all the factors. I emphasize: it is a question of judgment. No apology need be offered for that. Parliament has decreed that fair value be determined by the courts and not by a formula that can be stated in the legislation.

Where Parliament has called for judgment, and where judgment is being exercised, the scope of the judgment should not be obscured. If the judgment is about which formula to adopt, then that should be made clear; if the judgment is about the assumptions to which the formula is to be applied, then that also should be made clear; and if the judgment is about the final result, with the formula being treated only as an aid, then that should be apparent.

¶ 52 And at 653:

In summary, it is my opinion that no method of determining value which might provide guidance should be rejected. Each formula that might prove useful should be worked out, using evidence, mathematics, assessment, judgment or whatever is required. But when all that has been done, the judge is still left only with a mixture of raw material and processed material on which he must exercise his judgment to determine fair value.

Discussion

¶ 53 I prefer Mr. Barbour's valuation because I find it reliable, coherent, and reasonable in all the circumstances. Mr. Barbour's report of August 8, 2005 is a Comprehensive Valuation Report prepared by a member of the Canadian Institute of Chartered Business Valuators and in accordance with the standards of that Institute.

¶ 54 Mr. Barbour has clearly explained his methodology and reasoning, which is internally consistent. He has also concisely disposed of any questions arising from Mr. Symes critique of his report.

¶ 55 I also accept the Respondents' reply submissions, which accurately summarize Mr. Barbour's again persuasive and detailed critique of Mr. Symes' valuation report of May 31, 2006. Mr. Barbour's response, identified as his "Report #2", is dated November 8, 2006.

¶ 56 In his Report #2, Mr. Barbour identified five primary sources for the significant difference between his and Mr. Symes' valuation, one of which used the unconsolidated approach. He also provided a critique of the consolidated valuation, which was based on Mr. Gosset's Report. I will review these points, as I have found them to be persuasive.

¶ 57 First, with respect to the valuation of JPPL, Mr. Barbour suggested that Mr. Symes selected an unreasonably high predicted future income for JPPL. He noted that Mr. Symes

predicted April 30, 2005 cash flow for JPPL of \$144,198 based on September 30, 2004 interim financial statements. The normalized, actual cash flow for 2005, however, was \$103,323. Using this figure, after adjusting for annual capital expenditures of \$17,000, the revised cash flow is in the range of \$76,000 to \$87,000, rather than \$114,000 to \$144,000. This alone would result in a 35% reduction in Mr. Symes' value for the shares of JPPL, from \$1,075,000 to \$702,000.

¶ 58 Second, Mr. Barbour opined that Mr. Symes selected too low a capitalization rate for JPPL to be applied to the predicted future income, which resulted in a capitalized cash flow that is too high.

¶ 59 Mr. Symes selected capitalization rates of 9.83% to 15.83% to be applied to Earnings Before Interest, Taxes, Depreciation and Amortization ("EBITDA"), effectively a pre-tax cash flow.

¶ 60 The capitalization rates used by Mr. Symes were not developed by him, but were those developed in a report by Mr. Gosset, another expert for the Petitioner. Mr. Gosset himself, however, opined that some of the reported transactions from which his range of capitalization rates were derived are not representative of the market and suggested a much narrower range of 13% to 13.5% as appropriate. To put this in perspective, the low end of Mr. Symes' capitalization rate of 9.83% to be applied against pre-tax cash equates to an after tax rate of 6.33%. Mr. Barbour opined that it is unrealistic to expect that there are potential investors willing to invest in a private company, JPPL, with no tangible assets for a 6.33% rate of return on the investment.

¶ 61 The lower the capitalization rate selected, the higher the multiple created, and consequently, the higher the capitalized earnings. The effect of adjusting Mr. Symes' report for the revised income, annual capital expenditures and the narrower range of multiples suggested by Mr. Gosset reduces Mr. Symes' value of the shares of JPPL from \$1,075,000 to \$655,000.

¶ 62 Mr. Gosset's capitalization rates were derived from transactions that included both pub operations and real estate; in effect, this is akin to a consolidation of JPPL and MPMHL. Mr. Symes, in his valuation methodology, used an unconsolidated approach to valuing JPPL. If capitalization rates of 13% to 13.5% are appropriate for a business that holds real estate, the underlying asset that reduces risk, then a significantly higher capitalization rate is appropriate for a stand alone pub operation. Mr. Barbour suggested a 50% to 60% higher rate. Using an appropriate higher range of capitalization rates reduces the value of the shares of JPPL even further to \$436,000. This compares to Mr. Barbour's value of \$477,000 for the shares of JPPL in his valuation.

¶ 63 Third, with respect to the valuation of MPMHL, Mr. Barbour submits that Mr. Symes double-counted \$174,000 of "Excess Land" for MPMHL. That is, in addition to using the real estate value of \$864,000 as valued by Isle West Appraisals Ltd., an appraisal company which appraised the real estate holdings of MPMHL on October 4, 2004, Mr. Symes included an additional value of \$174,000 for "excess land". Isle West Appraisals Ltd.'s appraisal already included a value for the land which Mr. Symes refers as "excess".

¶ 64 Mr. Barbour also suggested that Mr. Symes erred in his treatment of the "Income Tax Shield" calculation for MPMHL. This error arose, Mr. Barbour suggests, because Mr. Symes assumed a share sale and Mr. Barbour an asset sale of MPMHL. Mr. Barbour suggested that it

would be very unusual for a potential purchaser to agree to purchase the shares of MPMHL rather than the assets and he noted that the large majority of Mr. Gosset's "comparables" were asset transactions. Whether a share sale or asset sale, however, the purchaser would want to factor in the potential tax debt of \$213,868 relating to the potential sale of the land and buildings, discounted by Mr. Barbour by 38% for a net value for the debt of \$132,598. Mr. Barbour suggested this would result in a reduction of the value of the shares of MPMHL as calculated by Mr. Symes by \$114,256.

¶ 65 If Mr. Symes' value for MPMHL is adjusted for double-counting the "excess land" and for the latent taxes on the potential sale of the land and buildings, the value becomes \$600,744. Mr. Barbour's value of the shares of MPMHL in his valuation report is \$602,480.

¶ 66 Fourth, with respect to 2211 Holdings, Mr. Barbour noted that Mr. Symes failed to reduce the assets of 2211 Holdings by \$210,000 to take into consideration the additional funds injected by Tri-Phi and Brian Phillips.

¶ 67 Fifth, Mr. Barbour suggested that Mr. Symes assumed that there would only be a sale of the shares of 2211 Holdings, with the result that there was no recognition of significant latent corporate taxes. However, Mr. Barbour suggested that in assuming that a prospective purchaser of the real estate and the pub operations would buy only the shares of 2211 Holdings, Mr. Symes did not take into consideration any of the potential income taxes which would be incurred by 2211 Holdings upon the disposition of its interest in the underlying subsidiaries, JPPL and MPMHL. Even in the unlikely event that there is such a potential purchaser, that purchaser would want to factor in a portion of the underlying taxes in calculating the value of the shares of 2211 Holdings. Using Mr. Symes' values for the shares of JPPL and MPMHL, there is an income tax liability on the sale of those shares by 2211 Holdings of \$258,000.

¶ 68 Notwithstanding this, if no adjustment is made to reflect the latent tax liability in 2211 Holdings, but all the other adjustments referred to above are made, Mr. Symes' value of \$1,446,000 for 100% of the shares of 2211 Holdings is reduced to \$309,000. This compares to Mr. Barbour's valuation for 100% of the shares of 2211 Holdings of \$344,723.

¶ 69 As I have alluded to, Mr. Symes provided two valuations in his report: one using an unconsolidated approach, the other adopting a consolidated approach. The second valuation is based on the earlier report of Mr. Gosset. The Petitioner has suggested a fair value for the Shares that appears to be the midpoint of Mr. Symes' second valuation. However, the Petitioner has not explained why this figure should be preferred over a figure drawn from Mr. Symes' first valuation.

¶ 70 Further, the Respondents note that Mr. Symes is a Chartered Business Valuator; Mr. Gosset is not. Mr. Symes has prepared his own valuation of 2211 Holdings. As an alternative, he has adopted Mr. Gosset's valuation on the same business he has valued. The Respondents submit that there are a number of reasons why Mr. Symes should not have adopted Mr. Gosset's valuation, not the least of which is that Mr. Symes is more qualified than Mr. Gosset to value the shares of 2211 Holdings.

¶ 71 In Mr. Barbour's Report #2, he also identified a number of factual and methodological errors in Mr. Gosset's report, in contrast to generally accepted professional business valuations standards.

¶ 72 For example, Mr. Barbour pointed out that Mr. Gosset incorrectly stated that the revenue from the pub and liquor store operations are blended. As a result of this mistake, Mr. Gosset made assumptions about the pub operation's revenue rather than relying on historical data. Mr. Gosset had extensive copies of financial statements for the Jingle Pot Pub which broke out the revenue as between the pub and liquor store operations.

¶ 73 Also, Mr. Barbour suggested that Mr. Gosset's prediction of future cash flow is unrealistic. Mr. Gosset predicted future cash flow of \$300,291. He did not deduct notional rent from this figure. This figure contrasts starkly with Mr. Barbour's range of \$85,000 to \$128,000 and Mr. Symes' range of \$114,000 to \$144,000 (and the revised range of \$76,000 to \$87,000 suggested by Mr. Barbour in his Report #2). In making this prediction, Mr. Gosset has essentially ignored the Jingle Pot Pub's historical gross profit and operating expenses and substituted amounts based upon "industry standards". It is not at all clear what "industry standards" Mr. Gosset utilized because his file produced for inspection in this matter pursuant to Court Order did not contain any information as to the alleged industry standards.

¶ 74 Mr. Barbour identified a number of specific examples of where Mr. Gosset used "industry standards" inappropriately in his report and the significant effect this has on the value figure set forth in the Gosset Report.

¶ 75 I also note Mr. Barbour's criticism that Mr. Gosset's Report inappropriately used hindsight data. Generally accepted business valuation principles prohibit the use of hindsight data except where such data can be used to test assumptions or predictions made at the valuation date. Mr. Gosset cited eight "transactions" in his report, three of which occurred after the valuation date and one of which was a real estate listing in September 2004 that was subsequently withdrawn.

¶ 76 There was no information in Mr. Gosset's file regarding the eight alleged comparable pub transactions listed in his report. As such, one can not determine the information Mr. Gosset had with respect to these alleged transactions, including the reliability of the financial information Mr. Gosset recited from them. There is no indication in Mr. Symes' report that he reviewed the underlying information that Mr. Gosset used in order to test its reliability.

¶ 77 Mr. Barbour directly contacted managers/shareholders of the purchasers involved in three of the eight transactions. A summary of Mr. Barbour's discussions with those managers/shareholders and his comments thereon are found in his Report #2.

¶ 78 Mr. Barbour's Report #2 further suggests that Mr. Gosset's selection of a capitalization rate of 13% to 13.5% is fundamentally flawed. This rate was developed by Mr. Gosset using the eight transactions cited in his report and therefore is based upon actual data, subject to the inaccuracies of Mr. Gosset's information regarding those transactions. But, as noted above, Mr. Gosset has substituted his own hypothetical future cash flow figures rather than relying on the Jingle Pot Pub's actual historical income. There is a significant risk that the Pub operation could not meet Mr. Gosset's hypothetical cash flow in the future and the capitalization rate must reflect

that risk. The capitalization rate selected by Mr. Gosset is too low to be applied against this hypothetical income figure.

¶ 79 Mr. Barbour has also criticized Mr. Gosset's valuation based on the fact that Mr. Gosset applied a multiplier to the gross sales figure in order to arrive at a value as an alternative valuation approach, noting that this is not a generally accepted approach. Mr. Barbour also notes that, like Mr. Symes, Mr. Gosset's valuation involved an assumption that there will only be a sale of the shares of 2211 Holdings and results in a lack of recognition of significant latent corporate taxes relating to the land and buildings in the amount of \$670,000. A prudent potential purchaser would want to have at least some portion of that latent liability reflected in the purchase price. The result of all of these errors is the potential for compounded, systematic error which would give rise to an artificially inflated appraisal value.

¶ 80 I also agree with counsel for the Respondents that it is notable that the Petitioner refused to inject \$50,000 to assist the other shareholders to comply with the Royal Bank's requirement for a pay-down of \$210,000 of the debt. This refusal reduced his equity in the company from 25% to 6%. Therefore, the 19% difference in his equity was worth \$50,000 to him. This demonstrates that assigning a fair value of \$86,181 to his 25% interest as at September 30, 2007 is likely not only fair, but generous.

¶ 81 In sum, for the reasons that I have set out, I accept Mr. Barbour's reports over those of Mr. Symes or Mr. Gosset. In coming to this conclusion, I have reviewed all of the points made by the experts for both the Petitioner and the Respondents, and choose to accept the appraisal of Mr. Barbour based on his detailed and coherent analysis.

Conclusion

¶ 82 The Petitioner seeks an order for interest on the share value from September 30, 2004. But there is no payment of interest to be made under the terms of the September 15, 2004 Order. Tri-Phi is ordered to pay the Petitioner the fair value of his shares as at September 30, 2004, and is entitled to receive the Petitioner's shares and the other relief as set out in paragraphs 4-6 of the Order.

¶ 83 I hereby find that the fair value of the Petitioner's shares in 2211 Holdings as at September 30, 2004 is \$86,181.

MacKENZIE J.

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