

Getting it right when it all goes wrong: Appraising the fair value of minority shares

In July 2011, in a case called HRH Prince Faisal v PIA Investments BVIHC(Com) 2011/03, the British Virgin Islands' ("BVI") High Court considered whether parties could contract out of the BVI statutory mechanism for the appraisal of shares following a forced redemption by the majority (often referred to as the "squeeze out" of minority shareholders). Justice Bannister also considered, albeit *obiter*, the issue as to whether any gloss should be put on the phrase "fair value" in section 179 of the BVI Business Companies Act 2004 (the "Act"), so as to create a protection against valuing minority shares at a discount by reason of their lack of marketability.

This decision is the first occasion upon which these issues have been considered and will be of interest to corporate lawyers advising their clients upon their rights in mergers, consolidations, sales, buy-outs, share redemptions and other corporate arrangements, which transactions also include the right for one or more minority shareholders to seek payment of fair value for their shares where they dissent to the proposed transaction.

Background

The material facts were that HRH Prince Faisal and Pakistan International Airways Corporation (PIA) had entered into a joint venture owning and operating several well-known hotels in the United States and Europe, using a BVI company. The parties had agreed restrictive terms in a shareholders' agreement which subordinated the company's memorandum and articles of association, and which contained a right of first refusal which provided that should either party identify a third party that wished to purchase its shares, it had first to offer them to the other shareholder on the same or better terms. Over a number of years, Prince Faisal had availed himself of this provision and had, in fact, made himself a minority shareholder through a series of dispositions of his shares to PIA. By reason of this diminution of his shareholding, ultimately, PIA was able to obtain the necessary majority to serve a notice of forced redemption for Prince Faisal's remaining shares. PIA's notice required his remaining shares to be redeemed at a certain price. However, Prince Faisal objected to the price offered and sought to initiate the statutory appraisal procedure under section 179.

The forced redemption of minority shares under the Act

Subject to the memorandum or articles of a company, section 176 of the Act provides for the compulsory redemption of minority shares by the majority. The statutory requisite majority is 90% of the votes of the outstanding shares

entitled to vote and 90% of the votes of the outstanding shares of each class of shares entitled to vote as a class. In these circumstances, the members holding these statutory requisites may give written instructions to the company directing it to redeem the shares held by the remaining members whether or not the shares are by their terms redeemable. The Company is required to serve the notice of redemption on the minority, assuming the statutory requisite is met, setting out the price and manner in which redemption is to take place.

The right to “fair value” under the Act

However, the Act provides that following a notice of redemption by the majority, a minority shareholder is entitled to payment of the “fair value” of his shares (s179(1)) and has the right to initiate a statutory process of appraisal (s179(9)). It should be noted that a right to fair value attaches to a minority shareholder in a BVI company in a number of major corporate transactions involving that BVI company, including where a minority shareholder dissents from a merger, consolidation, or a sale/disposition of more than 50% in value of the assets of the company outside the ordinary course of business.

The appraisal procedure under the Act

The statutory appraisal process is speedy and section 179 provides that if, within thirty days immediately following the date on which the offer is made, the company making the offer and the dissenting member agree upon the price to be paid for his shares, the company shall pay to the member the amount in money upon the surrender of the certificates representing his shares. However, if the company and a dissenting member fail, within the period of thirty days to agree on the price to be paid for the shares owned by the member, within twenty days immediately following the date on which the period of thirty days expires, the following shall apply:

- (a) the company and the dissenting member shall each designate an appraiser;
- (b) the two designated appraisers together shall designate an appraiser;
- (c) the three appraisers shall fix the fair value of the shares owned by the dissenting member as of the close of business on the day prior to the date on which the vote of members authorising the action was taken or the date on which written consent of members without a meeting was obtained, excluding any appreciation or depreciation directly or indirectly induced by the action or its proposal, and that value is binding on the company and the dissenting member for all purposes; and
- (d) the company shall pay to the member the amount in money upon the surrender by him of the certificates representing his shares.

The parties seek to avoid the Act's appraisal procedure

After negotiations under the Act broke down, Prince Faisal and PIA decided to enter into a protocol for determining the appraisal of the redeemed shares outwith the statutory procedure above. Eventually, the appraisal by reference to the protocol also failed and Prince Faisal brought an action in the BVI Court claiming that the statutory regime under the Act was a complete code for the protection of dissenters that could not, in fact, be contracted out of. Justice Bannister held that there was no reason why parties should not be allowed to contract out of the statutory valuation process and that there were certainly no public policy reasons that would preclude them from doing so. The Judge held that: "The mechanism provided by the [Act] for the valuation of dissenters' shares is merely machinery for establishing a price. If a particular dissenter prefers other machinery, he is not, as I see it, giving up some protection which he would have had under the [Act] but does not get under the private agreement. He is merely choosing a different route to achieve the same end". Equally, it is difficult to see why a party, who is *sui juris*, should not be bound by a contract that has been properly entered into.

Determining value and the minority discount

Following this conclusion, it became unnecessary to determine the question as to whether "fair value" under section 179 means an appraisal that does not reduce the valuation of a share where it is a minority holding and judge's reasoning on this point is therefore *obiter*. Justice Bannister noted that the valuation of shares in section 179 applied to five different situations including forced redemptions. What might be fair in one circumstance might not be fair in another. "Fair value" therefore was at least capable of meaning different things in different cases, and the minority discount approach was, in any event, only one component in determining fair value. For example, a determination of fair value might well require an assessment of the nature of the business of the company. Where assets based valuations might be appropriate, an earnings approach might not be. It might be the case that where an assets based approach was used, the minority discount had no application at all. The judge noted that "fair" must apply to the fairness to both parties, but that no particular gloss should be put on the phrase to impose a rule that a discount could not be applied due to the lack of marketability of minority shares.

Conclusion

This case gives welcome certainty to the possibility of contracting out of the statutory appraisal regime for shares. Further, it provides interesting *obiter* reasoning in furtherance of a flexible and commonsensical approach to the valuations of shares held by minority shareholders in BVI companies, where such shareholders have dissented to a major corporate transaction.

Further Information

The foregoing discussion and analysis is for general information purposes only and not intended to be relied upon for legal advice in any specific or individual situation.

HARNEYS

For more information on this subject, please contact Ian Mann (ian.mann@harneys.com) in our Hong Kong office or Simon Hudd (simon.hudd@harneys.com) in our London office.

September 2011