EXPERT DETERMINATION: HIGH COURT TAKES A WINE TOUR

By Timothy Lindsay & Jay Shaw

*A recent High Court decision[1] involving well-known Central Otago winery Peregrine Wines (**PWL**), which concerned a shareholder dispute arising from the application of a standard form share transfer mechanism in PWL's constitution (the **Constitution**), highlights some of the key features of the expert determination process (particularly as a method of determining fair value for the purposes of shareholder buy-outs). The judgment provides important guidance for both the lawyers drafting expert determination clauses in shareholder agreements, and experts themselves in discharging their valuation mandates.*

Background

PWL is a boutique producer of premium (and enjoyable) Central Otago wines, specialising in Pinot Noir. The plaintiffs (the trustees of the Greg Hay Family Trust) (the **Trustees** and the **Trust**) and the defendant Peregrine Estate Limited (**PEL**) are the shareholders in PWL, with the Trustees holding 25.14% and PEL 74.86%.

The Trustees determined to sell the Trust's 25.14% shareholding in PWL. Accordingly, in March 2013 the Trustees approached PEL inviting them to make an offer. PEL responded with an offer of $1.568 million. The trustees, however, believed the Trust's shares to be worth considerably more, $3.25 million. PEL was not prepared to pay the Trust's price, but confirmed that it would buy the shares at "fair value" fixed in accordance with the valuation procedure in Clause 11.4 of the Constitution. PWL's Constitution was a standard form 'Avon Publishing' document, with the relevant provision (Clause 11.4) printed without alteration.

PWL appointed a valuer in accordance with Clause 11.4 (the ***Valuer***), who produced a valuation report (the ***Valuation Report***) determining the "fair value" of the Trust's shares to be $2.62 million. PEL declined to complete a purchase at this figure and instead engaged its own advisor who provided an alternative fair value assessment of $1.275 million. High Court proceedings ensued. The Trustees sought specific performance (by way of summary judgement) of PEL's obligation to buy the shares at the Valuer's fair value of $2.62 million.

High Court decision

The High Court upheld the Trustee's application for summary judgment and ordered PEL to perform its obligation to buy the Trust's shares at the Valuer's valuation of $2.62 million. In doing so, Matthews J made three key findings, each of which provides important guidance for drafters of expert determination clauses and valuers alike:

- The Valuer had fixed "fair value" for the purposes of Clause 11.4 of the Constitution;
- The valuation was final and binding on the Trustees and PEL; and
- The valuation also fixed "fair value" for the purposes of s149 of the Companies Act.

Did the expert fix "fair value" for the purposes of Clause 11.4 of the Constitution?

Yes. The High Court highlighted two key pieces of evidence which, in the Court's view, made it unarguable that the "figure arrived at is other than the fair value required under clause 11":

- *Engagement letter:* the Valuer's engagement letter (signed by PWL's two directors, one of which was also the sole director of the defendant PEL) instructed the Valuer to determine the "fair value" of the Trust's shares in PWL. Relevantly, the engagement letter expressly drew the distinction between "fair value" and "fair market value".

- *Valuation Report:* the Valuation Report made clear (for example, in recording the Valuer's mandate, and setting out the Valuer's basis of valuation) that the Valuer was valuing the "fair value" of the Trust's shares.

These findings highlight the importance of an appointed expert, in accordance with the parties' contractual terms, documenting and discharging his or her mandate accurately.

Was the valuation final and binding on the Trustees and PEL?

Yes. Although PEL sought to argue that the valuation was not final and binding because the Valuation Report did not so state, the High Court rightly noted that Clause 11 "specifically provides that the determination of the expert appointed under that clause will be final."[2]

Importantly, in rejecting PEL's challenges to the substantive merits (i.e. correctness) of the Valuation Report, the High Court went on to confirm the general principle that expert determinations are final and binding, with very limited scope for review by the courts. A court cannot intervene to review the substantive merits of an expert's determination—even if the expert is patently wrong; the only avenue of review is where the expert has exceeded his or her mandate. Citing recent consideration of these issues by the Court of Appeal, the High Court confirmed that:

> "[32] As noted in the passage cited from Waterfront Properties, the Court may intervene only where an expert has departed from his or her mandate in a material respect and failed to do what the expert was appointed to do. It is insufficient to show that the expert has made a mistake, was negligent or is even patently wrong. The thrust of the evidence presented for PEL, by way of a report from Mr J C Hagen, chartered accountant, is that Ms Millar made a mistake, and that she was wrong in her assessment of fair value. Even if correct, that would be insufficient to avoid the otherwise binding effect, for the purposes of the constitution, of her assessment."[3]

In turn, and again providing practical guidance to lawyer-drafters and valuers alike, Matthews J rejected PEL's arguments that the Valuer had exceeded her mandate.

- *No deficiency of reasons:* PEL's argument that the Valuer did not provide adequate reasons to support the valuation in her Valuation Report failed. Neither Clause 11 nor the terms of the Valuer's appointment placed any obligation on the Valuer to provide reasons. Citing authority from the High Court of Australia, the High Court noted of the expert determination process:

> "...the parties to an expert determination cannot use s149 as a backdoor route to re-litigating a fair value determination."

"The evident advantage of an expert determination of a contractual dispute is that it is expeditious and economical. The second attribute is a consequence of the first: expert determinations are, at least in theory, expeditious because they are informal and because the expert applies his own store of knowledge, his expertise, to his observations of facts, which are of a kind with which he is familiar"[4]

In practical terms (and perhaps less understood in commercial practice), a valuer's mandate (as reflected in both a contractual expert determination clause and engagement letter) should expressly state whether the engagement is either speaking (with reasons) or non-speaking. Both modes of delivery have their pros and cons. Non-speaking engagements tend to 'end the dispute' and, with more abbreviated reporting requirements, be more cost effective. A decision with reasons enables the parties to understand the experts reasoning, but leaves the door slightly ajar to challenge. In NZ, speaking engagements tend to be the norm, possibly due to a lack of awareness about the alternative option.

- *Minority shareholding discount*: PEL's "most trenchant" criticism of the Valuation Report was that the Valuer did not apply a minority shareholding discount to the value of the Trust's (minority) shareholding. This criticism, however, amounted to no more than a challenge to the merits of the expert's conclusion, which was not a reviewable error. As Mathews J concluded:

"[45] In my view these aspects of Mr Shiels' argument only raise the prospect that Ms Millar was mistaken in her view, or possibly that she made an error in not enquiring further on this point. This does not amount, however, to departing from her mandate to assess fair value." [5]

- *Delegation of authority:* PEL also complained that the Valuer had delegated her authority impermissibly, because she had sought the advice of a law firm in relation to the application of a minority discount. This complaint was rejected on the facts. On the evidence before the High Court the Valuer had, albeit with the benefit of having received advice, arrived independently at the conclusion that a minority discount should not be applied. In practice, a valuer is therefore able to seek advice from a third party for an issue that falls within their mandate but would be unwise to rely on that advice without undertaking their own evaluations.

The Valuer had properly discharged her mandate in *Peregrine*, and therefore there was no basis to review her assessment of fair value.

Did the expert's valuation also fix "fair value" for the purposes of s149 of the Companies Act?

Yes. In an important finding, Matthews J held that the Valuer's "fair value" determination also fixed "fair value" for the purposes of s 149 of the Companies Act. Section 149 of the Companies Act provides that, in given circumstances, directors may only acquire shares at or above "fair value", and dispose of them at or below "fair value".

PEL submitted that setting the "fair value" for the purposes of s 149 of the Companies Act was the sole province of the High Court. It argued that, even if parties agree on a fair value, that may still not bind them if, on an objective assessment, it is found (by a court) that they have agreed on a figure that is not in fact "fair value". On PEL's case, because the Valuer's fair value was substantively wrong on an objective assessment, it could not be binding for the purposes of s 149.

In the circumstances, the High Court rejected PEL's argument. Because (as discussed above) the Valuer had not exceeded her mandate there was no basis to conclude that the Valuer had not determined the "fair value" of the Trust's shares. In turn, there was no basis not to enforce her valuation for the purposes of s 149. As Matthews J noted:

> "... The short and, quite frankly, simple point is that the Act requires the shares to transfer at fair value. It is not open to the parties to agree that they transfer at a value assessed on any other basis, or that they transfer at a price which later turns out not to be fair value ...
>
> [82] In the present case the parties have not agreed to assess the value on any basis other than fair value, and have not agreed on a figure at all, whether it be by reference to fair value or not. They have agreed in the constitution, and reiterated by the subsequent shareholders' agreement, that shares will be transferred at fair value, and no other figure. I do not discern any basis on which fair value should be said to bear one meaning for the purposes of the constitution, yet another for the purposes of s 149. Fair value is a well-recognised concept of valuation and the same phrase appears in both the constitution and s 149." [6]

In turn, the High Court distinguished a position where specific performance would be unavailable if that would involve a breach of s 149. In *Peregrine*, however, the High Court was

> "not being asked to do something which is unlawful. It is being asked to enforce an independent assessment of fair value, as required by s 149, undertaken in accordance with a process provided for in the company's constitution. Asher J was referring to the agreement in Fong v Wong, which was to assess fair market value, not fair value. That did not comply with s 149. The material difference between that position, and the present case, is evident."[7]

This finding has important practical consequences. As demonstrated on the facts of Peregrine, it means that parties to an expert determination cannot use s149 as a backdoor route to re-litigating a fair value determination. The High Court has confirmed the final and binding nature of expert determinations with respect to share valuations, and therefore should find support from the commercial community.

Concluding observations

Peregrine highlights the main feature of expert determination, which is its final and binding nature. This means greater commercial certainty for the parties to the process; a faster process by reducing avenues of challenge to excess of mandate; lower costs; and flexibility and certainty over timing. However, it is precisely because of its binding nature that parties should be aware that once a share valuation process is underway, there is little way back—even if there is fundamental disagreement with the valuer's conclusions. Current media reporting indicates that the High Court's decision may be appealed, and so any future developments in this case will be watched with interest.

End Notes

[1] *Hay & Hollows v Peregrine Estate Ltd* [2016] NZHC 2097

[2] *Ibid* at [31].

[3] *Ibid* at [32], referring to *Waterfront Properties (2009) Ltd v Lighter Quay Residents' Society Inc* [2015] NZCA 62, [2015] NZAR 492 at [29] (emphasis added).

[4] *Ibid* at [35], citing *Shoalhaven City Council v Firedam Civil Engineering Pty Ltd* [2011] HCA 38, (2011) 244 CLR 305 at [25].

[5] *Ibid* at [45].

[6] *Ibid* at [81]-[82].

[7] *Ibid* at [85].

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