Neutral Citation Number: [2023] EWHC 2406 (Ch)

Case No: CR-2018-005729

IN THE HIGH COURT OF JUSTICE
BUSINESS AND PROPERTY COURTS OF ENGLAND AND WALES
COMPANIES COURT (ChD)

The Rolls Building
Royal Courts of Justice
7 Rolls Buildings
London EC4A 1NL

Date: 06/10/2023

Before :

ICC JUDGE MULLEN

- -

IN THE MATTER OF INTEGRATED CONTROL SOLUTIONS (EASTERN) LIMITED

AND IN THE MATTER OF THE COMPANIES ACT 2006

BETWEEN :

TIMOTHY McMONAGLE

Petitioner

- and -

(1) LEE HARVEY
(2) TRACEY McMONAGLE
(3) MARIA HARVEY
(4) INTEGRATED CONTROL SOLUTIONS (EASTERN) LIMITED

Respondents

- -
- -

Mr Nicholas Michael (instructed by **Fosters Solicitors LLP**) for the **Petitioner**
Mr Jack Watson (instructed by **Howes Percival LLP**) for the **First Respondent**
The Second Respondent did not appear and was not represented
Mr Matthew Morrison (instructed by **Advocate**) for the **Third Respondent**
The Fourth Respondent did not appear and was not represented

Hearing dates: 19th – 20th June 2023
Further written submissions: 23rd June 2023

- -

Approved Judgment

This judgment was handed down remotely at 10am on 6th October 2023 by circulation to the parties or their representatives by e-mail and by release to the National Archives (see eg https://www.bailii.org/ew/cases/EWCA/Civ/2022/1169.html).

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ICC JUDGE MULLEN

ICC Judge Mullen :

Introduction

1. This judgment follows on from my judgment following the trial on liability on the petition and cross-petition under neutral citation number [2021] EWHC 1374 (Ch) ("the Liability Trial") and should be read with it.

2. Following that judgment, the parties instructed Mr Stephen Reed of Price Bailey LLP, a firm of chartered accountants, as a single joint expert to provide an opinion on the market value of the Company's shares and the price payable by Mr McMonagle for Mr Harvey's shares, taking into account the determinations in the judgment. Mr Reed is a senior corporate finance partner at Price Bailey LLP, a member of the Institute of Chartered Accountants and has held a corporate finance advanced diploma for more than 15 years. He is experienced in, among other things, the valuation of small and medium-sized enterprises. He is also very familiar with this case. Over the life of this dispute he has produced:

    i) a valuation of a 25% shareholding in the Company, dated 8th April 2020 ("the Original Report");

    ii) an addendum report responding to questions raised by the solicitors acting for Mr McMonagle and Mr Harvey, dated 7th May 2020 ("the Addendum Report");

    iii) a further valuation report following my judgment after the Liability Trial, dated 22nd May 2023 ("the Final Report");

    iv) a response to questions raised on behalf of Mr McMonagle and Mr Harvey under CPR 35 in respect of the Final Report, dated 2nd June 2023 ("the First Part 35 Responses"); and

    v) a response to two further questions put to him on behalf of Mr Harvey, dated 19th June 2023 ("the Second Part 35 Responses").

    The reason for the delay in producing the Final Report was, it seems, that various inconsistencies were identified in the Company's financial information, which brought to light further anomalies and cast doubt on the reliability of the Company's Sage data. Mr Reed considered it necessary that the Company's accounts as at 3rd April 2018 be restated. This was carried out by Price Bailey LLP's business team and gave rise to a further need to modify the figures for previous years. Mr Reed was not involved in this exercise but he understands that the adjustments primarily related to the treatment of bad debts, VAT liabilities and liabilities under the Company's warranty provisions. The accounting treatment of these has been the subject of further disagreement between the parties, further prolonging the production of the valuation.

3. Once the exercise had been completed, Mr Reed produced the Final Report. He has provided an enterprise valuation of the Company, which is accepted to be appropriate. He has valued the Company at £496,935 and applied a minority discount of 30% so as to attribute a value of £86,964 to Mr Harvey's shareholding. This valuation is based on applying a multiplier of 5 to the earnings before interest, taxes, depreciation and amortisation ("EBITDA") figure that he has produced. He has made further adjustments on the basis of my judgment following the Liability Trial and determined

that the price payable by Mr McMonagle for Mr Harvey's shares is £48,991, assuming that Mr Harvey retains certain equipment in his possession.

4. I should mention one further development since the Liability Trial. Ms Harvey, though she attended the trial, had not filed points of defence or presented her own petition in relation to her own shareholding. Following judgment in the Liability Trial, and having obtained legal advice, she presented a petition under case number CR-2022-003660. At a case management hearing on 20th March 2023 I gave directions for Ms Harvey's petition to be listed at the same time as the hearing to consider valuation. This was on the basis that Ms Harvey argued that Mr McMonagle was estopped by the findings in my judgment following the Liability Trial and, if so, it would likely have been possible to determine a price at which Mrs Harvey's shares should be bought by Mr McMonagle. In the event, Mrs Harvey's petition was settled on terms that are not known to Mr Harvey or to me. The only question that remains is that of costs. Costs will fall to be determined following the handing down of this judgment.

Issues

5. At this hearing, it was submitted on behalf of Mr Harvey that:

   i) Mr Reed has assumed directors' salaries far in excess of those actually paid and the EBITDA figure should be recalculated on the basis of the latter;

   ii) the adjustments to the financial statements of the Company were made necessary by failings on the part of Mr McMonagle or the Company's accountants, Larking Gowan, in preparing the financial information and should be left out of account insofar as they depress the value of the Company;

   iii) the EBITDA multiplier selected by Mr Reed is too low and this results in part from the unreliability of the Company's financial information for which Mr Harvey should not be penalised;

   iv) The minority discount is too high and should be reduced to reflect that Mr McMonagle is, once his wife's shares are taken into account, already a 50% shareholder in reality.

   On behalf of Mr McMonagle there were criticisms of Mr Reed's apportionment of one director's salary to reflect Mr Harvey's limited involvement in the Company in the five months prior to 3rd April 2018 and his treatment of Mr Harvey's director's loan account. Mr Michael also contended in his oral submissions that the minority discount should in fact be higher, though this was not foreshadowed in his skeleton argument and he appeared to concede that a 30% discount was broadly right.

6. Mr Reed was not called to answer these points and a number of them were not put to him in the form of written questions either. I would have been assisted if they had. Both parties acknowledge that arriving at a value, particularly in these circumstances, will necessarily be something of a broad-brush exercise.

Approach to valuation

7. Counsel helpfully set out the approach to be taken in their respective skeletons. I do not propose to rehearse these in full as they are not contentious but there are some particular points that I bear in mind. The learned author of *Hollington on Shareholders' Rights* (9th ed.) says this of share valuation at paragraph 8-45:

   > "This is a very wide and specialist subject, on which one would be tempted to defer to the expertise of share valuers. This

> temptation is to be resisted, however, because there are questions of law and principle involved in the present context, share valuation is an art not a science (*Joiner v George* [2003] B.C.C. 298), and a court retains a wide freedom to disregard the views of experts and apply the court's view of what is fair and sensible in all the circumstances: *Re Bird Precision Bellows* [1986] Ch. 658 at 669; *Re Planet Organic Ltd* [2000] B.C.C. 610 Ch D."

Thus the court's task is to establish a value which is fair and sensible and it is not bound by a single joint expert's opinion. Nor do decided cases offer more than limited guidance as they turn on their own facts and the quality of the expert evidence adduced in them. The starting point for the valuation of a shareholding in an unquoted company is usually the value of the company as a whole assuming a hypothetical willing, but not anxious, seller and buyer (*Holt v Holt* [1990] 1 WLR 1250 at 1252E).

8. In arriving at an appropriate minority discount (if applicable), His Honour Judge Hodge KC, sitting as a High Court Judge, said in *Re Lloyds Autobody Ringway Ltd* [2018] EWHC 2336 (Ch) at paragraph 113(5):

> "The choice is not necessarily between an undiscounted and a fully discounted valuation. The wide terms of s994 leave it open to the court to order the purchase of the petitioner's shares at some middle figure, involving an intermediate discount, where neither a pro rata valuation nor a minority shareholding valuation would be fair…However, in my judgment such cases are likely to be rare; and the court must beware of applying 'palm tree' justice before adopting some middle course."

9. Bearing those principles in particular in mind, I will address the parties' contentions.

Adjustments to EBITDA

<u>Directors' salaries</u>

10. Mr Reed has approached this as follows in his Final Report:

> "5.14 I have made the following assumptions with regards to directors' salaries.
>
> > a) The market rate salary reflective of the Petitioner and First Respondent's roles in the business are estimated at £75,000 each, hence I have added back existing salaries taken and substituted a total cost of £150,000 plus employer's national insurance contributions in the years where both individuals were active in the business (assuming tax years equal financial years for ease with regards to thresholds).
> >
> > b) It would appear as though the First Respondent's productivity fell in the five-month period from November 2017 to his resignation on 2 April 2018, hence I have discounted his market rate salary by 50% in these months. I have made this assumption because the Petitioner and First Respondent have made opposing claims in relation to the First Respondent's contribution through this five-month period. In the absence of any evidence to support either argument I have taken a mid-point by assuming his

> productivity fell to 50% and reflected market rate salary accordingly."

11. Mr Watson, on behalf of Mr Harvey, correctly notes that neither Mr McMonagle nor Mr Harvey received £75,000 per annum by way of salary. He criticises Mr Reed's approach on the basis that –

    i) No comparables are provided to show that this would represent a market rate salaries.

    ii) It artificially deflates the earnings of the Company and is not justified where one director will continue to work in the Company while one has retired.

    iii) It does not reflect what was actually paid. Mr McMonagle and Mr Harvey received a small monthly salary and further "dividends" in lieu of salary which equated to remuneration of £33,000 per annum.

    iv) Salaries of £75,000 cannot be justified given the earnings of the Company.

    v) While it is submitted on behalf Mr McMonagle that, when other benefits were taken into account, the directors' overall remuneration package was significantly in excess of £33,000 per annum, these benefits have already been provided for in Mr Reed's valuation.

12. Mr Reed was not asked why he considered the figure of £75,000 to represent the market rate even though he included this figure in his Original Report in 2020. He was asked about this figure rather more obliquely following his Final Report. He sets out the question and his answer in the First Part 35 Response:

    > "**Question: 6**
    >
    > Paragraph 5.14 assumes a salary of £75,000 for both directors. Given that no salaries were paid above £300 per month, what would be the effect on valuation if salaries were only £300 per month?
    >
    > **Response: 6**
    >
    > If salaries of only £300 per month were paid, no national insurance or employer pension contributions would be payable either on account of the monthly salary being below the required thresholds. This approach would therefore assume that a director working in the Company would take home £3,600 per annum for his role which I consider to be completely unrealistic."

13. Again, in the Second Part 35 Response, he was asked what the effect of providing for salaries of £33,000 for two directors would be. He was not challenged on his selection of the figure. Mr Reed's response was as follows:

    > "If director salaries of £33,000 per annum were paid rather than the £75,000 rate I have currently allowed, and if the additional benefits equivalent to 10% of salary costs were removed this would increase the equity valuation to approximately £775,000."

Given the difference between the salary figures used by Mr Reed and those proposed on behalf of Mr Harvey, it should have been apparent that this would likely have a significant effect on the EBITDA. It is thus surprising that this was not raised in terms.

14. It is not obvious to me that Mr Reed's approach is wrong. It does not follow that a hypothetical buyer would simply look at what had in fact been paid to the shareholder directors in the past. A buyer of the Company as a whole might, for example, wish to appoint non-shareholder directors who have no financial interest in the growth of the business beyond their salaries. Similarly it may be that, were a second director to be appointed to act with Mr McMonagle, that director would wish for director's remuneration to be paid by way of salary at the market rate and there would be some restructuring of remuneration. I cannot speculate. Mr Reed's view as an expert are not determinative but they are his assessment of the market salary, made in the full knowledge of what the directors actually received. There is nothing before me to suggest that the correct approach, or a more accurate approach, is to look at what had been paid historically. Nor can I pluck a figure from the air somewhere between actual remuneration and Mr Reed's assessment of the market rate.

15. The reduction to reflect the period during which Mr Harvey's contribution to the business was limited has similarly not been interrogated by the parties. Mr Michael submits that it rewards Mr Harvey for his failure to devote proper energy to the business. Mr Reed has not been asked to explain this and he has simply said that he has chosen 50% as a result of the dispute as to how much time Mr Harvy did in fact devote to the Company in the five months prior to 3rd April 2018. I can see how the overall time devoted to the business by each of the directors might provide an indication to Mr Reed of the level of input required from the directors appointed by hypothetical buyers. Again, I do not know because Mr Reed has not been asked but I see no basis to depart from Mr Reed's assessment.

16. These points should have been put to Mr Reed directly so that they could have been addressed and I was not referred to anything to suggest that his approach is wrong in principle. There is no reason not to accept his professional judgment and I do so.

VAT adjustment

17. Mr Reed discusses this as follows in the First Part 35 Response in the context of expressing his view as to whether any errors were the responsibility of Larking Gowen:

> "VAT interest and penalties is based on Price Bailey's Business team's view of the risk of penalties following a review of a sample of VAT returns. In their view, the best case scenario would be if the Company were able to reduce the penalties down to the range of 10-25% of what HMRC would initially demand and as such, a provision of 15% of the possible penalties was made in the accounts. The output VAT was paid late as a result of an error in the accounting system which was not caused by Larking Gowen but which it seemingly did not identify either; this is not unexpected where Larking Gowen's role was to prepare the accounts from the accounting records provided to it by the Company. Unless Larking Gowen was engaged to prepare the VAT filings for the Company then it would not necessarily have been within the scope of their work. Price Bailey's Business team discovered these VAT issues only as a result of further investigation."

18. Mr Harvey's position is that any errors in VAT returns were the responsibility of Mr McMonagle, who said in his written evidence for the Liability Trial that he was "responsible for the financial management of the Company". A document setting out the respective responsibilities of the directors also lists the following as being responsibilities of Mr McMonagle:

> "Weekly cash flow
>
> Weekly financials, sage and data
>
> Monthly financials, sage and data
>
> Quarterly financials, sage and data
>
> End of year financials, sage and data
>
> Info to Larking Gowen"

Leaving aside the question of how the directors apportioned responsibility for financial reporting between themselves, precisely how the alleged errors arose is unclear.

19. Mr Harvey's case is that the potential liability to HM Revenue and Customs should be left out of account in calculating the EBITDA figure. If the responsibility lies with Larking Gowen a claim can be made against it. Likewise, if the error can be traced to a mistake by an employee, that employee can similarly be pursued.

20. I do not agree. While Mr McMonagle has accepted primary responsibility for the financial affairs of the Company, there is no evidence that the fault lies wholly with him. Both directors bear a degree of responsibility for ensuring that there was a proper system of financial reporting in place. The errors may be the fault of either or both of them, or entirely innocent mistakes by employees which are no more than "one of those things". The sums involved are very modest. I cannot assume a culpable failure on the part of Mr McMonagle from which Mr Harvey should be held harmless and it would be wholly disproportionate to embark on an enquiry as to circumstances in which any errors occurred. It is likely that a reasonable buyer would wish to take account of the possibility of a further liability for tax. I see no reason to interfere with the account that Mr Reed has taken of this.

Warranty provisions

21. The Company accounts contained provision for warranty claims of a percentage of the three prior years' turnover, being 1.25% for the most recent year and at 0.6% for the previous two years. Mr Harvey pointed out that the contractual obligation of the Company was to provide warranties for 12 months and that provision should be made at 1.25% of turnover for the most recent year. Mr Reed deals with this as follows in the First Part 35 Responses:

> "The warranty provision adjustment is on the basis that, historically, the warranty provision was included in the accounts based on a percentage of the three prior years' turnover being at 1.25% for the most recent year and at 0.6% for the previous two years; this is the view of the Petitioner. The Respondent understands that the Company has a contractual obligation to provide warranties for 12 months and thus a warranty provision at 1.25% of turnover is appropriate. The Price Bailey Business team has considered comments

> made from both the Petitioner and the First Respondent and determined an appropriate provision to be based on two years, being the most recent year at 1.25% and the previous year at 0.6%. Again, this is a matter of judgement and not necessarily an error of Larking Gowen but having sight of the contracts would have assisted both Parties."

22. Again, Mr Reed made this comment in the context of addressing whether there were errors attributable to Larking Gowen. The reference to the provision for these liabilities being a matter of judgment and the adoption of Price Bailey's two year approach suggests that this is a legitimate way of approaching these liabilities, notwithstanding the provisions in the contracts. Presumably Price Bailey's approach reflects some residual costs attributable to earlier warranty claims or perhaps some provision for more extensive warranty provisions that might have been accepted in individual cases. In my judgment, too much weight is attributed by Mr Harvey to Mr Reed's reference to the usefulness of having sight of the contracts. These Mr Harvey maintains have been withheld by Mr McMonagle, thus allowing him to procure a lower value for shares. It appears clear to me however that Price Bailey considered the positions of the parties and exercised professional judgment, limiting provision for warranties to a two year period. It is not suggested by Mr Reed that there needs to be a determination of the terms on which the Company contracted with each of its clients with sight of the contracts in order to produce a more accurate figure. Nor does he suggest that, if the contractual warranty was as described by Mr Harvey in all cases there would be any significant change in the value of the shares. Nothing leads me to conclude that the approach adopted by Mr Reed is inappropriate or reflects any unfairness towards Mr Harvey, nor does Mr Reed's discussion suggest fault on the part of Mr McMonagle in the way that the warranties were provided for historically. The balance here again lies in favour of following Mr Reed's approach. Mr Harvey does not appear to have objected to the way in which provision was made for warranty claims in the past and Price Bailey's approach makes a small adjustment in his favour. Again, it would be wholly disproportionate to investigate the terms on which each transaction was entered into.

<u>Bad debts</u>

23. In the First Part 35 Response Mr Reed says:

> "The bad debt provision adjustment is as a result of Price Bailey's Business team replacing bad debt estimates with the actual provisions required at each period end, to ensure that prior periods have been prepared on a consistent basis. This is a more accurate approach which is possible when the accounts are prepared with a greater delay following the year end than that which Larking Gowen would have had the benefit of and, therefore, this does not imply that Larking Gowen's approach was erroneous at that time but rather Price Bailey's Business team had the benefit of hindsight in undertaking their work."

This adjustment therefore derives from there being real, rather than estimated, figures available to Price Bailey and does not suggest any failings on the part of Mr McMonagle in the production of earlier figures. I appreciate that hindsight is usually inappropriate when undertaking a valuation but (a) it appears to have been a necessary part of ensuring consistency and (b) it appears that bad debts were reversed as part of the "normalisation" of the accounts. It does not appear that these adjustments have had any significant effect on the value. I accept Mr Reed's approach.

Multiplier

24. In his Original Report, Mr Reed employed a multiplier of 4 on the basis of his consideration of available comparables, although in the event he discounted all but one of the transactions for which information was available to him. He concluded that Larkin Gowen's opinion that a multiple of three was appropriate to be too low on the basis that the Company operated in:

> "a niche and specialised industry so I would expect it to command a slight premium against similarly sized businesses operating in less specialist areas, but would fall short of the multiples seen in the UK200 benchmark index, which relates to larger and more valuable company transactions on average."

25. In his Addendum Report in the same year he explained why he had chosen to discount certain potential comparators put to him by the parties. He considered that the sale of a company called Optyma Security Systems Limited ("Optyma") with an EBITDA multiple of 5.4 had some comparable features but its financial outlook was better than that of the Company. He said:

> "I note that Optyma exhibited growing trend revenues of £6.4m (FY17), £5.6m (FY16) and £5.9m (FY15) in the three years prior to its acquisition in December 2017. Therefore, notwithstanding the questioner's comment to me that Optyma offered a narrower range of services than ICSEL, I would argue that the more stable and growing financial performance of the Optyma business in the period prior to its acquisition contributed it to achieving a higher multiple than I believe ICSEL warrants, which itself has not demonstrated the same level of stability in revenue or EBITDA with fluctuating and generally declining results."

26. He did however consider that there were substantial similarities between the Company and a company called Breathing Buildings Limited ("BBL"), a comparable provided by Mr Harvey, which had an EBITDA multiplier of 19.4. He still identified significant differences however. He addressed it as follows:

> "2.30 In light of the detailed commentary provided at Question 12, I acknowledge that there are substantial similarities between ICSEL and Breathing Buildings Limited ('BBL'), to a larger extent than I had previously appreciated. I also note that much of the information referenced in question 12 represents a level of commercial awareness outside my expertise, and perhaps also not in the public domain and if I take it at face value, is compelling.
>
> 2.31 Whilst I now accept the transaction is comparable to a larger extent than acknowledged in the Valuation Report, I am still not convinced that the 19.4x EBITDA multiple sourced from MarktoMarket (an online subscription database) is a reliable metric. I believe it is a product of anomalies in underlying data used by analysts at MarktoMarket. In my experience of advising on SME company acquisition and disposal activities, it is rare to see a company of BBL's type and size commanding an earnings multiple in excess of 10x EBITDA, regardless of the industry in which it operates."

27. It is notable too that BBL's turnover was £8.2 million, with a gross margin significantly in excess of that of ICS. Mr Reed also records that the purchaser of BBL regarded its acquisition as:

> "a significant milestone, which it regarded as the market leader and as a pioneer in natural and hybrid ventilation systems since 2006, with which it had become very successful within the new build education".

28. He explained that the UK200 Group SME Valuation Index did not provide an appropriate set of comparables. He said at 2.39:

> "Whilst I acknowledge that ICSEL is servicing part of a growing market, as per my high level industry overview comments at paragraphs 5.13 – 5.15 of the Valuation Report, my concern with applying a multiple as high as 6.1x-6.2x per the UK200 Group SME Valuation Index is that the Company has not been able to demonstrate a substantial enough level of EBITDA, to proximate to the vast majority of companies included in the survey s illustrated in Table 1 above. In line with reasons cited at 2.16, it is reasonable to apply a lower valuation multiple to a business earning a considerably lower level of sustainable EBITDA, even in cases where the companies operate in the same market. On balance, however, I consider a multiple of 6x EBITDA is appropriate given the analysis above, the additional information now provided and upon further contemplation of the comparable transaction history and broad similarities established with ICSEL in offering IBMS in a growing market."

On the basis of the information provided as to BBL, however, he considered that his initial assessment of the applicable multiplier was too conservative and that a multiplier of 6 should be used. It is relatively clear that he did not consider that BBL was a direct comparator but it exercised a gravitational pull away from his initial assessment that a multiplier of 4 should be applied.

29. By the time of his Final Report a further comparable called ETON Associates Limited ("ETON") had become available. He explained:

> "In the sample of deals disclosed in Appendix 5 of my Original Report dated 8 April 2020, this included the 2015 T-Mac Technologies Ltd deal which was based on an EBITDA of £0.3m and an EBITDA multiple of 73.3x (Appendix 1). As noted in paragraph 4.15, in updating my research to remove deals beyond the Valuation Date, I have found and included ETON Associates Limited, which had an EBITDA of £0.4m and an EBITDA multiple of 4.3x (Appendix 1). These two deals deftly illustrate why a multiple applied does not solely reflect EBITDA but of course the true normalised earnings as noted at paragraph 2.33 of my Addendum Report."

His explanation of why he now considered a multiple of five to be appropriate is set out at paragraph 5.45 of the Final Report:

> "In my Original Report of 8 April 2020, I applied an EBITDA multiple of 4.0x which, following further information provided

to me, I revised upwards to 6.0x in my Addendum Report of 7 May 2020. I have now determined that an appropriate EBITDA multiple is 5.0x and the reasons for this are as follows.

a) The financial results for FY18 show that revenue has declined by over £1m and the Company was in a loss-making position, with costs appearing unable to be reduced to match the fall in revenue quickly enough. A buyer would have questioned the value of the Company at the time of such results being achieved.

b) The information received from Larking Gowen in relation to the accounts, including the Company's Sage data, has revealed a number of apparent anomalies therein, resulting in a number of adjustments to the accounts previously prepared for the Review Period. Again, a well-informed buyer, as part of the normal financial due diligence process prior to purchase, would likely have discovered the same anomalies in the financial data which would in all likelihood have affected their confidence in the results of the business and which would likely be reflected in a lower offer and thereby a lower EBITDA multiple.

c) The accusation that the First Respondent diverted revenue away from ICS(E)L and the breakdown in relations between the First Respondent and the Petitioner would have been worrying indicators to a buyer of the Company, although I note that Judgment paragraph 252 indicates the Judge believes the downturn was mainly due to the departure of Mr Crawford, not due to business diversion/neglect from the First Respondent. In any event, such matters arising in due diligence would have concerned a buyer.

d) My experience of valuation work informed by many years of advising on SME company acquisition, disposal and equity fundraising activities.

5.46 The application of an EBITDA multiple of 5x to the weighted average normalised EBITDA of £74,145 results in an Enterprise Value of £370,727 (Appendices 2 and 3) based on the earnings method."

30. In my judgment Mr Reed has provided a consistent, considered and coherent approach over the course of his valuations. It is evident that BBL skewed the multiplier upwards somewhat when Mr Reed considered further representations in relation to it when preparing the Addendum Report, but he expressed misgivings as to whether it was a reliable comparator or that the multipliers provided by the UK200 Group SME Valuation Index were applicable. By the time of the Final Report he had the benefit of an additional comparator, ETON, which, together with Optyma, fortified his misgivings and justified a more conservative approach to the multiplier.

31. He also noted that the anomalies identified in the financial information would supress the multiplier. In the Second Part 35 Responses, Mr Reed explained that had the anomalies not been identified this would have had a modest effect on the multiplier – increasing it by 0.2. I cannot safely attribute responsibility for all of the anomalies to

Mr McMonagle and these appear to be only one of the factors that Mr Reed considers would have suppressed the multiplier. Nor can I assume that the anomalies in the financial data would not have been discovered by a buyer, either as part of its due diligence in considering the figures or as a result of identifying that a restatement exercise had taken place. I accept Mr Reed's judgment as to the appropriate multiplier as set out in his Final Report.

Minority discount

32. In the First Report in 2020 Mr Reed assessed the possible approaches to discount on the basis of two different scenarios –

    i) The first ("Scenario 1") is based on the acquisition by Mr McMonagle of either Mr Harvey or Mrs Harvey's 25% shareholding so that he, together with Mrs McMonagle, held 75% of the shares.

    ii) The second ("Scenario 2") is that Mr McMonagle acquires either Mr Harvey or Mrs Harvey's shares, having already acquired the other "Harvey" shareholding so that, together with Mrs McMonagle, he would control 100% of the shares.

33. His approach to these questions was set out as follows:

> "6.7 In the absence of any advice prescribed by the Articles, my judgement on application of minority discounts in 6.6.1 and 6.6.2 has been informed by section 6.7 of the ACCA Technical Factsheet 167. This technical document advises use of a minority discount of 33% for uninfluential minority interests in the context of valuation disputes. I believe a 30% discount is appropriate for the market value of a 25% shareholding, having no regard to implications of effective holdings post transaction as per scenarios 1 and 2. Having regard to these scenarios, however, I believe that the aforementioned minority discount of 30% should be reduced to:
>
> 6.7.1 15% in scenario 1 to reflect the 75% effective control gained by the Petitioner when acting in concert with the 2nd Respondent (his wife); and
>
> 6.7.2 0% in scenario 2 to reflect the 100% effective control gained by the Petitioner when acting in concert with the 2nd Respondent (his wife). The implication being that there is no difference between market value in scenario 2 (6.6.2) and both fair value valuations in each case at respective valuation dates (6.6.3 and 6.6.4)."

34. The Final Report considered the matter further. Having established the valuation of the Company as a whole he says as follows:

> "5.7 I have subsequently provided a valuation figure for a 25% shareholding with the application of a minority discount as directed by the Approved Judgment, paragraph 248.
>
> 5.8 In the absence of any advice prescribed by the Articles, my judgement on application of minority discounts has been informed by section 6.7 of the ACCA Technical Factsheet 167. This technical document advises use of a minority discount of

up to 33% for uninfluential minority interests in the context of valuation disputes. I believe a discount in the range of 0% to 33% is appropriate for the market value of a 25% shareholding, depending on the intended purchaser and in this instance I have applied a minority discount of 30%, having no regard to implications of effective holdings post transaction."

35. The relevant parts of the technical factsheet are as follows:

"6.1 Where the valuer is asked to value an interest in a private company that is less than a 100% interest, it may be appropriate for that interest to be discounted from the full pro rata value. The level of the discount will depend upon various factors, including the size of the interest, the spread of other interests, the degree to which the shareholding is locked in and the pattern of dividend payments, both historic and going forward. The following range of discounts might be considered to be a reasonable starting point in deciding on the level appropriate in any specific instance:

● Majority holdings in excess of 50% - a discount of 5% to 10%.

● 50% interests - a discount of 15% to 25%, depending on the split of the other interests.

● Interests of 26% to 49% - a discount of 30% to 40%.

● Interests of 10% to 25% - a discount of 45% to 55%.

● Interests of less than 10% - a discount of 60% to 75%.

6.2 Discounts for size may be minimal for shareholdings in excess of 75% and be small (say 10%) for interests of 51% to 74%. This reflects the fact that at 51% and above the interest controls the company on a day to day basis and an interest of 75% and above can pass a special resolution.

6.3 50% interests can be difficult to value. Much will depend on the nature of the other interests in the company. If the 50% interest is faced with a single other 50% interest then a deadlock position ensues and a larger discount (perhaps of 25%) may be appropriate. Where, however, the 50% interest is the single largest interest and the other 50% is held by a number of small shareholdings, then the discount may reduce to, say, 15%. In a position where one of the 50% interests has a casting vote then this is, in effect, a majority interest and should be discounted accordingly.

6.4 For uninfluential minority interests of 26% to 49% then the discount might be between 30% and 40%, increasing to between 45% and 55% for interests of 10% to 25%.

6.5 For interests of less than 10% a discount of between 60% and 70% might be appropriate.

6.6 The valuer should bear in mind that all of the above discounts are broad guidelines only, and will vary according to the facts of each case. In addition, it might be that a 10% interest has strategic value (for example, where only two other interests of 45% each exist in the company). In such a circumstance the interest may have considerably more value than it would in normal circumstances.

36. Mr Reed was questioned on his approach. He set out his responses in the First Part 35 Response.

"**Question: 21**

Paragraph 5.8 indicates a range of minority discounts between 0% and 33% has been considered. Why, in circumstances where the shareholding is relatively significant, has a discount close to the top of the range been selected.

Response: 21

Guidance provided by ACCA Technical Factsheet 167, suggests that a shareholding of up to 25% could attract a discount of 45% in a normal market valuation but it also remarks that in instances of disputes, such a discount is likely to be too high and that 'a discount of no more than, say, 33% may be appropriate'."

37. In response to a question on behalf of Mr McMonagle he said

"**Question: 22**

Paragraphs 7.37 and 7.38: ACCA Technical Factsheet applies a discount of between 15% and 25% where the Petitioner will obtain a 50% shareholding and states that 'Where, however, the 50% interest is the single largest interest and the other 50% is held by a number of small shareholdings, then the discount may reduce to, say, 15%...'

(1) Given that the Petitioner will obtain an interest of 50% and the other shareholding will be split between two shareholders, why is a discount of 15% not the appropriate discount?

(2) Why has a discount of 30% been applied in excess of the recommended discount?

(3) If the court was to consider the Petitioner and his wife's shareholding to be linked such that he would obtain a 75% interest in the company, what would the appropriate discount be (noting that this would give the ability to pass both general and extraordinary resolutions)?

Response: 22

For the avoidance of doubt, question 22 refers to a response I provided to a question raised on my Addendum Report.

> (1) Where the Petitioner would obtain a 50% shareholding with the remaining 50% held by two other shareholders one of which was his wife (and as such it would possibly be considered normal for her to act in conjunction with the Petitioner) and thus effectively creating a scenario whereby the Petitioner has a 75% controlling interest in the Company at which point I would consider 15% to be appropriate.
>
> Where the Petitioner and his wife would not be considered to be linked, I have deemed a 30% discount rate to be reasonable rather than 15% as a consequence of valuing the 25% shareholding in isolation from the final resulting shareholding.
>
> (2) The application of a 30% discount is in my view entirely appropriate for the valuation of a 25% shareholding in the context of a dispute. I was, as per paragraph 248 of the Approved Judgment, asked to value Mr Harvey's shares 'with a discount to reflect that they represent a minority holding'. I have interpreted this as focusing solely on the value of the 25% obtained rather than considering this in the context of a combined shareholding with the Petitioner's 25% which would not represent a minority holding.
>
> (3) If the Petitioner and his wife's shareholdings were considered to be linked by the court such that the Petitioner would obtain an effective 75% controlling interest in the Company, I would consider an appropriate market discount to be in the region of 15%.

38. It is impossible to avoid the conclusion that Mr McMonagle and Mrs McMonagle's shareholdings are linked. As explained in my judgment following the Liability Trial, Mr McMonagle and Mr Harvey acquired 50 shares each of the 100 issued shares of the Company in 2001. They later transferred half of their shares to their wives. Mr McMonagle accepted in his oral evidence during the Liability Trial that "each couple was treated as a team". The flavour of the documentation is that neither Ms Harvey nor Mrs McMonagle were particularly interested in the business in their capacity as shareholders. I found that Mrs McMonagle was used as a conduit for Mr McMonagle's remuneration following the cessation of the payments of dividends in 2018 and despite her employment by the Company was not involved in it to any great degree. She has not engaged substantively with these proceedings at all. In my judgment, the rights attached to Mrs McMonagle's shares are at the disposal of Mr McMonagle for all practical purposes such that he must be regarded as controlling 50% of the share capital. On that basis it appears to me that Mr Reed's suggested discount of 15% is applicable. That reflects the ACCA guidance to which I have referred. I leave out of account the acquisition of Ms Harvey's shares. The terms of this are not known and post-date the valuation date that I have determined.

Director's loan

39. This is dealt with at paragraph 5.18 of the Final Report:

> "5.18 …unauthorised company withdrawals in the amount of £61,664 occurred between February 2018 and February 2019. These amounts were posted to the First Respondent's director's loan account and as such, this amount (of which £28,311

occurred during FY18), has not affected the profit and loss account and therefore no adjustment is needed to EBITDA. Having looked at Sage for each of the transactions which comprise the £61,664 in turn, they have all been posted to the First Respondent's director's loan account with the exception of an amount of £5 in relation to bank charges which we could not locate as a posting in Sage.

5.19 It is feasible that as at the date Mr Harvey left the company then no further transactions should have arisen however whilst we note transactions occurring until 26 February 2019, we are not aware of any other movements on Mr Harvey's director's loan account after that date. Whilst the withdrawals made were unauthorised they were accounted for correctly and reduced the amount owed to him by the Company; as such, if Mr Harvey were to repay the £61,664, because he was at 3 April 2018 owed £33,717 by the Company, this would simply serve to further increase the amount due to him by £28,311 being the withdrawals taken before his resignation date. I have, as part of the normal equity adjustment exercise, deducted the value for the directors' loan accounts, however on the basis that as at the 3 April 2018 balance sheet date £33,717 was owed to Mr Harvey, I have offset this against the post year-end unauthorised withdrawals of £33,353 and thus the net £363 is owed to Mr Harvey. I have added this amount to the purchase price payable to the First Respondent."

40. Mr Harvey accepts the expert's figures to be correct. Mr Michael has not persuaded me that there is any error of principle or of calculation in this approach. Reviewing the material provided at for the Liability Trial I cannot see that the sums claimed to be due to Mr Harvey in respect of his director's loan to be in issue. I cannot see any objection in principle to Mr Reed's approach and, again, the matters that Mr Michael seeks to raise were not put to him.

Conclusion

41. In the result, I consider that no adjustments are needed to the EBITDA figure, or Mr Reed's treatment of the director's loan account. Similarly the EBITDA multiplier of 5 appears to be to be properly reasoned and there is nothing to justify departing from it. As Mr McMonagle has effective control of the rights attached to 50% of the shares in the Company the minority discount applicable to Mr Harvey's shares shall be 15%. There are no features which justify any further reduction in the discount.

42. I shall ask that the parties seek to agree the final figure, with the assistance of Mr Reed if necessary, following the circulation of the draft judgment.