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## VALUATION

## Valuations of Unlisted Shares – is there a difference between Fair Market Value and Fair Value?

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*"Price is what you pay. Value is what you get"*  
**Warren Buffett**

*"Among some accountants and some lawyers, on or off the Bench, there seems to be a persistent disinclination to accept, or at any rate to act on, the principle of such decisions. It may reflect a yearning for the certainty of rules of thumb, or a sense that shares and other items of property must have an intrinsic value capable of being revealed by some formula. The latter, however, is an illusion. Money value is simply what is obtainable in an actual or notional market. In some cases, such as shares quoted on the stock exchange, it is easily ascertained. At the other extreme are cases where the valuers can do little more than identify the factors likely to influence the parties in bargaining for a fair price in a friendly negotiation, and then arrive at a discretionary judgment."*

**Statement by Court of Appeal President Justice Cooke in *Holt v Holt* [1987] 1 NZLR 85 at 90, when analysing some of the key Court decisions on valuations.**

Valuation of unlisted shares can be a difficult and sometimes controversial exercise.

Reflecting a traditional view to equate value with price, and price with a 'market' price, there has been a tendency to value unlisted shares by reference to 'the market' or 'a hypothetical open market' or 'a hypothetical closed market', and for people outside of the valuation profession to call all of these 'market value' or 'fair market value', or simply 'fair value'.

Since these concepts are underpinned by analogies with the 'market', or some other process for exchange, it is not surprising that 'market value', 'fair market value', and 'fair value' have tended to be viewed as the price that fully informed, freely contracting, parties offer and accept – put another way, as being the price described by Justice McCarthy in *Hatrick v Commissioner of Inland Revenue* [1963] NZLR 641 "at which a willing but not anxious vendor would sell and a willing but not anxious purchaser would buy" (at 661).

Capital market theory also suggests that there is generally a discount for a minority stake and/or where there are any perceived or established impediments to marketability.

This all works well where the market price or a hypothetical open market price appears to represent real or intrinsic value (or worth) for the shares being considered. The valuer adopts the market price or assumes a hypothetical open market and a transaction taking place in that market on an arm's length basis. Valuers treat this as a fair market value approach to value.

But to assume a hypothetical open market in the absence of a market price is not always appropriate. Situations often arise in the context of unlisted companies where there is not a market in the normal sense of there being fully informed and freely contracting parties and multiple buyers (the market being constrained). Examples are breakdowns in relationships between shareholders who are effectively partners, directors selling their shares, relationship property cases, and shareholder oppression cases. In these quasi-partnership cases, drawing an analogy with a market is often simply an exercise in fiction, as the sale is often forced rather than voluntary and/or the situation can tend to be more illustrative of a fiduciary situation than an arm's length investment where caveat emptor might be expected to apply. In these cases, an open market is not necessarily the obvious analogy for the situation that has to be considered.

A solution in these quasi-partnership cases is for the valuer to adopt what valuers see as a fair value approach and seek to reflect a specified closed market comprising the shareholders only. Instead of the valuer assuming a hypothetical open market and a transaction taking place in that market on an arm's length basis, the parties to such a transaction are taken as having been defined and specified, usually the existing shareholders. Nevertheless, it is usually still an 'exchange value' that the valuer is trying to determine. However, this approach usually does not involve applying a discount in assessing the value of a minority stake and/or impediments to marketability.

So, in this spectrum, are there different approaches that can only be explained by reference to the concepts of fair market value and fair value? Or is it possible that in both cases the valuer is simply looking for a real or intrinsic value, guided usually by exchange value principles?

The Court of Appeal (*Fong v Wong* [2011] NZCCLR 2) and the Supreme Court (*Fong & Anor v Wong & Anor* [2010] NZSC 152) have both suggested that there may be scope for argument as to what, if any, difference there is between fair market value and fair value – the Supreme Court stating that they are "arguments which in practice may depend on the relevant legislative or contractual context" (at [7]).

**The debate: do valuation standards imply methods and adjustments?**

At one level, it is reasonably easy to draw a distinction between fair market value and fair value. Fair market value can be seen as a measure to apply where an informed open market, albeit often a hypothetical market, can reasonably be assumed. On the other hand, fair value can be seen as a measure to be applied where there is no real external purchaser (operating on an arm's length basis) that can be hypothesised without resorting to fiction, and hence no market in that sense, but only the shareholders.

In an open market, market forces apply and the price reflects any discount for trading in minority (unitary) stakes, and any impediments to marketability reflected in 'thin' trading. A fair market value, determined by reference to a hypothetical market price, is usually assumed to involve a discount for these factors and therefore a discount is normally applied in calculating fair market value. Fair value, on the other hand, is often applied in closed 'market' situations as tends to be the case with closely held companies, and assumes that buyers and sellers will act equitably toward each other. Therefore, fair value generally does not include a discount for such factors.

Perhaps not surprisingly, these distinctions have developed such that, irrespective of the factual situation and circumstances to which they are applied, a valuer usually treats fair market value as involving a discount for a minority stake and/or impediments to marketability, but usually treats fair value as involving no discount for these factors (see Hagen, "Valuing Shares and Businesses", August 1990 at 6 and 7 for a discussion of the distinctions that have developed).

In treating these terms as representing two separate valuation standards, valuers have identified and emphasised distinctions between them and interpreted these as representing two distinct valuation methods with prescribed or inherent adjustments. Fair market value is sometimes perceived by valuers as closely resembling market value. Seen this way, the word 'fair' simply describes the smoothing process applied to a market value or hypothetical market value to remove anomalies created by peaks and troughs in market activity or assumed value adjustments. Under this view, fair market value essentially accepts market value or a hypothetical market value (subject to the smoothing) as the best representation of real or intrinsic value (*Domglas Inc v Jarislowsky, Fraser & Co Limited* (1980) 13 BLR 135 (Quebec)).

Determining a fair market value does, however, involve a careful analysis. An assumption is made of a hypothetical open market that is fully informed, where the shares are freely transferable and the parties trade as non-anxious buyers and sellers on an arm's length basis. Fair in the context of fair market value is considered by valuers to require a focus on the worth of the shares having regard to the relative position of the seller vis a vis other shareholders, any differences ie non-alignment in the collective rights attaching to the pro rata or proportional benefits between the shares being valued and the other shares in the company (such as in the ability to appoint directors), and/or the behavioural practices that can be expected of a majority shareholder (a minority shareholder being expected to accept the practices of the majority so long as they do not amount to oppression). As a result, a non-alignment of rights and/or expected behavioural practices of the majority usually involve a valuer attaching a discount for a minority stake and/or perceived impediments to marketability. However, the discount is not automatic, but attracts as a result of an assessment by the valuer that these factors do or could exist and impact on value.

Determining a fair value is treated by valuers as involving a different analysis and set of adjustments to that used for determining fair market value. Valuers do not see fair value as requiring them to try to identify a market value or a hypothetical market value, adjusted only to smooth out peaks and troughs in market activity or assumed value adjustments. In applying fair value, they assume there is not an open market, that the parties are known, that they are not trading at arm's length, and that restraints on transferability can be a constraint on value. Valuers see fair value as requiring a valuer to determine a value in the particular circumstances as between the likely parties to the transaction, usually the shareholders, and for that value to be just and equitable ie fair as between the parties with emphasis on distributing and allocating benefits in a fair manner. Viewed this way, fair value is seen as requiring an assessment of what the buyer gains and what the seller gives up and as requiring an equitable sharing of gains and losses so that neither party is advantaged or disadvantaged. Hence the primary focus is not on the relative positions of the parties and any non-alignment of those relative positions and/or behavioural practices of the majority. As a result, a valuer is less likely to find that a minority stake attracts a discount under fair value. Fair value is also seen as needing to reflect the original expectations of the parties as part of a consideration of all relevant circumstances. Some people even see fair value as not being restricted to any objective criteria, but rather as a subjective standard requiring a value to be set having regard to general notions of fairness (again, see Douglas for an expansive description of fair value).

Despite the distinctions that have traditionally been drawn between fair market value and fair value, in calculation and methodology application, the Courts have tended to use these concepts, or accept them being used, interchangeably in a manner that points to their similarities rather than any distinctions between them. Courts have focused on determining a value which is suitable in the applicable circumstances rather than on using prescriptive adjustments which may be implied by a valuation standard that assumes a particular context for the transaction.

Notwithstanding comments in some cases to the contrary, the balance of authority favours the proposition that fair value, just like fair market value, is an objective test and does not involve general notions of fairness (see, in particular, *Teh v Ramsay Centauri Pty Ltd* [2002] NSWSC 456 at [12]).

Under both concepts, the valuer is usually trying to determine an exchange value, ie a probable buy and sell price. Under fair market value, the market value or a hypothetical market value is usually assumed to represent real or intrinsic value of the interest being valued. When fair value is used, there is often no actual or hypothetical market value to benchmark against, and a value is determined by reference to what the seller gives up and the buyer acquires, ie what the parties to the transaction give and receive.

Moreover, the fair market value standard does not necessarily involve just a smoothing of the peaks and troughs in market activity, and otherwise accepting 'market value'. Courts have sometimes been critical of the tendency to over-emphasise market value as an indicator of real or intrinsic value. The 'fair' in fair market value can therefore be seen as the qualifier to market value aimed at ensuring the result of the valuation process is a real or intrinsic value. Viewed this way, fair market value can be seen as akin to fair value (see *Holt v Cox* (1994) 15 ACSR 313, at 334).

Also, while the fair value standard is expressed as requiring what is just and equitable between the parties, that value is usually expressed as being what benefit the buyer gains and what the seller gives up. Requiring that these represent an equitable sharing of gains and losses means that they must equate, ie that value is exchanged and not extracted by one party at the expense of the other. Shared expectations effectively mean the expectations of the parties relating to a future sale of the shares, ie as not involving any discount for the lesser bargaining power of the minority when the

sale needs to be effected. Viewed this way, fair value can be seen as akin to fair market value, since it is also directed at value rather than fairness (again, see *Holt v Cox* at 336 to 338, paragraphs 14 to 16).

Even the discounts usually associated with a fair market value approach are not an automatic function of that approach, but rather of any non-alignment of rights between the shares being valued and the other shares in the company and/or any behavioural characteristics of the majority that the valuer considers can be expected to be exhibited and consequently impact on value. If the circumstances are such that these factors cannot properly be considered to impact on value then they should not attract a discount under fair market value. Conversely, if they do, and don't amount to oppression, then, depending on the circumstances, they may justify a discount under fair value.

Some expressions of the fair value test indicate that it might differ from fair market value by allowing for 'compensation' over and above payment for value, particularly where there is special value that might accrue to the buyer. However, the weight of authority is now against this proposition, unless the special value is truly inherent in the shares rather than anything the buyer may do with them. At most, it might involve a 'liberal estimate' of value (but still being of value) in an expropriation case (see Australian Securities & Investments Commission Regulatory Guide 111.50, and *Holt v Cox* at 336).

Therefore, despite the wide terms in which the fair value test is usually expressed, it is arguable that the application of the test usually means no more than attempting to determine a real or intrinsic value in a position where no market exists, and that it does not involve elements of compensation over and above payment for value, let alone any payment to reflect notions of fairness.

This is not to say that there are not situations where the statutory or contractual context requires or allows for more general notions of fairness to be considered. Oppression cases under section 174 of the *Companies Act* 1993 are clearly cases that permit an enquiry that can go beyond value since there the Court is not required to determine value, but is given a discretion to make such order as it considers just and equitable in the circumstances. Arguably, it is only where a valuer or the Court has jurisdiction to do what is just and equitable in the circumstances, and not confine the enquiry to a determination of value, that general notions of fairness in allocating benefits and worth should enter the analysis.

In the normal situation, however, it is arguable that fair market value and fair value, are not distinguishable. Rather than seeing the word 'market' as a distinguishing characteristic, it is arguable that the words 'fair' and 'value' are the key words in both concepts. Moreover, it can be argued that 'market' is simply an indicator that a market value is a prima facie guide to exchange value, the latter being a concept common to both fair market value and fair value. One commentator has suggested that a reason for fair value being used is to differentiate market value from market price, which tends to reinforce the view that fair market value and fair value are similar concepts, both aimed at avoiding over-reliance on market prices (see W Loneragan, "Commercial Law: Fair value, market value, or fair market value?" (2000) 38(5) Law Soc J 46). Notwithstanding the differences traditionally identified between fair market value and fair value, both are directed at a best possible assessment of exchange value in specified contexts.

In some cases, irrespective of the approach taken, there is arguably no exchange value of any kind that is appropriate. For instance, in property relationship cases where the Courts have had to consider values for shares that are the product of estate planning exercises which split voting shares from income shares, it can be difficult to try and value the shares having regard to any notion of exchange. Shares that have different rights attached to them tend to have different values, irrespective of any differences valuers traditionally make in determining fair market value and fair value. However, while the value in these cases can almost come down to an educated guess, it nevertheless still amounts to an objective attempt to determine real or intrinsic value, rather than being an exercise in fairness (see *Holt v Holt* [1990] 3 NZLR 401 (PC), where the Privy Council noted that (and appeared to wonder why) it was not invited to consider any principle other than the willing buyer/willing seller concept. See also *Cronin and Mackintosh v Mackintosh and Wilson* [2011] NZCA 408, at [26]).

It is also important to distinguish between cases where valuation is the issue and cases where the real issue is what to value in the first place. The former can include situations where the shares are considered to have special benefits or a special value that a purchaser can be expected to pay for, and therefore are included in the assessment of value. The latter can include any special value that might accrue to the purchaser post acquisition where the weight of authority is to the effect that they are not benefits attaching to the shares being purchased, but benefits derived by the purchaser post acquisition. What needs to be considered in assessing the value that a purchaser can be expected to pay for is the additional benefit derived by the acquirer of the shares and which is inherent in the shares being transferred. It can nevertheless be difficult to distinguish between these two situations, particularly where both appear to involve an element of 'greenmail'. However, the compromise that appears to have been reached by the Courts reflects a view that in quasi-partnership situations a discount for a minority stake and/or lack of marketability is usually not justified, but nor is any special value that is not properly attached to the shares but is more properly regarded as a benefit that accrues to the purchaser post acquisition (see Australian Securities & Investments Commission Regulatory Guide 111.50).

Outside the area of valuation, for the purposes of accounting standards, fair value can be seen as basically the same concept as fair market value, representing an attempt to define value, based on the exchange value concept, but not extending to 'just' and 'equitable' considerations.

#### Convergence?

In the *Hatrick* case, the Court made the point that "the method of approach must not be elevated to become the test itself. It is only an aid to ascertain the market value" (at 662). In some cases, valuers have been criticised for being too rigid and insisting that a fair market value test must invariably involve a discount for a minority stake and/or impediments to marketability. Conversely, in other cases, lawyers have been criticised for attempting to disregard established valuation principles in situations such as relationship property cases where normal valuation principles still apply.

One can only speculate what the Court of Appeal or the Supreme Court would have held in *Fong* if they had been called upon to decide whether the valuer had correctly applied the test it did apply, which was a fair market value test. In the High Court, Justice Keane (at [54]) concluded that even on the basis of fair market value, the valuer was incorrect to discount the value to the extent that it did (*Wong & Anor v Fong & Anor* (High Court, Auckland CIV-2009-404-2469, 16 December 2009)). However, the Court of Appeal and the Supreme Court were not prepared to do this, and simply concluded that the valuer had not applied the required fair value test (but nevertheless

raised questions whether there was any real difference between fair market value and fair value).

#### **The MMAL case**

If one is to look for an answer to this question, a starting point is *MMAL Rentals Pty Limited v Bruning* [2004] NZWCA 451, (2004) 63 NSWLR 167 (the *MMAL* case), since that was a case referred to by all three Courts in *Fong*, and it was an instance where the Court concluded that fair market value and fair value standards produced different values.

That case involved the valuation of a minority stake where the Court had to consider not only what the contractually agreed 'free market value' meant, but whether it differed from an overriding statutory requirement that the contract be a fair contract.

The Court in the *MMAL* case drew a distinction between fair market value and fair value as it:

- (a) considered that the contractual test of 'fair market value' did not involve "the wide ranging approach applicable to the determination of a fair value" (at 54); and
- (b) found that the fair market value of the shares was only about half their fair value.

However, it is arguable that the distinction the Court drew should be attributed to the particular legislative context against which fair value was determined, and not be regarded as establishing any general principle.

Looking first at how the Court assessed fair market value, it took a traditional approach to the extent that it started with a hypothetical open market value. The Court also treated the test as exchange value-based. But it also considered that fair market value in that case should not reflect matters relating to control and/or marketability. By doing this, the Court took an approach that a valuer might take in determining a fair value since it did not require a discount for a minority stake and/or lack of marketability. In taking this approach, the Court can be seen as reflecting comments made in *Holt v Cox*, where that Court appeared to view fair market value and fair value as similar concepts.

When it came to fair value, the Court in the *MMAL* case saw this test as different from fair market value. The Court considered that fair value went beyond an exchange bargain process and involved a consideration of the full range of circumstances. In assessing these circumstances, the Court had regard to the original expectations of the parties and the fact that the ultimate benefits to the minority shareholder in terms of the commercial advantages that had accrued were significantly less than for the majority shareholder. The disparity between the commercial advantages accruing to the parties was the factor that in the Court's view justified an additional payment under the fair value test, which it considered could not be justified under a fair market value test.

So was the Court right in reaching this conclusion? The Court did accept that to the extent that these commercial advantages amounted to special benefits, they could be taken into account under a fair market value test. The fact that they were not fully reflected in the Court's fair market value test was because the Court viewed the minority shareholder's argument here as extending beyond special benefits value, and representing an attempt to compute present value based on future benefits. While the minority shareholder appeared to argue for a value based on future benefits, the fact remains that the benefits at issue were existing benefits that the majority shareholder had been able to extract by virtue of its shareholding in the company. This being the case, and notwithstanding that the benefits were seen as being of special value to the purchaser, rather than the vendor, they nevertheless appeared to be benefits derived from the operation of the business, and therefore capable of also being reflected in a value of any of the shares.

A better explanation given by the Court for its finding was that the commercial advantages to the majority shareholder had been derived over and above the capital, risks, and effort within the company. However, the Court also concluded that the fair value payment was "some recognition of the value of the business" that the Court considered it was required to take into account. This seems tantamount to an acknowledgment that the extra payment was still a payment for value that the purchaser could be expected to pay under the fair market value test, rather than a payment for something over and above capital that could only be justified by a "wide ranging approach" to fair value.

Had the benefits truly been derived by the majority shareholder "over and above" the capital, risks, and effort within the company (such a value would have represented value specific to that investor – investor value), then it is difficult to see how the minority shareholder could have been compensated under any test of value, including under a fair value test. It is arguable, therefore, that the benefits in question either justified a payment under both tests of value, or they could not be taken into account under either test, in which case, a payment could only be made based on oppression and the Court's jurisdiction to do what was just and equitable, irrespective of value.

It needs to be remembered that the Court in the *MMAL* case was asked to fix a fair value in the context of a claim that the contract was an unfair contract for the purposes of the Australian *Industrial Relations Act* and, alternatively, oppressive. In fact, the Court's analysis of fair value begins with the heading: "The Unfairness Case". Therefore, the Court had jurisdiction to consider the case in terms of general notions of fairness rather than fair value.

Despite the finding in the *MMAL* case, the factors referred to above suggest that the case is not a strong authority for the proposition that there is a difference between fair market value and fair value.

#### **Section 149 of the Companies Act**

Section 149 applies to share dealings by directors. It effectively requires directors to abstain from dealing or acquire at not less than fair value or dispose at not more than fair value. Its purpose is to prevent the abuse of inside information by directors. The section applies irrespective of whether the inside information is disclosed to the other party and aims to ensure that the sale price reflects the value of the information.

Section 149 does not define fair value. The section was considered in *Thexton v Thexton* [2001] 1 NZLR 237 (HC) and [2002] 1 NZLR 780 (CA), where the dispute was over whether section 149 applied. The director argued, unsuccessfully, that the section did not apply where both parties had the information, or it was not relied upon. There was no dispute that the value agreed by the parties did not represent the fair value of the shares.

While not strictly part of their decisions, the High Court and the Court of Appeal in the *Thexton* case made some important observations regarding fair value. Both Courts regarded fair value as an objective concept. While an agreed price was put to one side when section 149 was applied, there is

a clear indication from the judgment of the Court of Appeal that fair value under section 149 is nevertheless an exchange value test. The Court considered that even if the information is disclosed, "it is still material as affecting the price willing but not anxious buyers and sellers would consider fair" (at [15]). Given the observations the Court made regarding the objectivity of the test, it is likely to have intended 'fair' to mean 'true' or 'proper' and reflective of intrinsic value, rather than indicating some more general notion of fairness. The Court of Appeal also pointed out that a consequence of the strict "abstain or transact at fair value" approach is that it avoids any arguments about the extent of the disclosure of confidential information, and whether it is understood. Arguably, this is another indicator that under section 149 the more general notions of fairness are not meant to intrude into the analysis. Interestingly, the case was a situation where the High Court would not have been prepared to find that there had been oppression. Hence the High Court considered that the case was not an instance of unfairness in that more general sense.

The Fong case was also not a case of oppression. The Thexton case and its objective test of fair value was considered by the High Court in *Fong*. However, *Fong* was decided in the Court of Appeal and the Supreme Court simply on the basis that the fair value test had not been applied.

In the Supreme Court in *Fong*, the Court did observe that in cases of breakdown of relationships between shareholders, a discount for a minority stake would usually not be 'fair' as between vendor and purchaser, in terms of:

- (a) the alternative (ie winding up);
- (b) what each gains and gives up on the transaction (note that this is essentially the exchange value test); and
- (c) the quasi-partnership nature of the underlying relationship.

The Court went on to state that the price established by such a valuation process is customarily referred to as 'fair value'.

It might be thought from the above statements that the Supreme Court regarded fair value as involving general notions of fairness. However, the Court also said that arguments about the basis of valuation may depend on the relevant legislative or contractual text. The Court made its comments here after canvassing a range of scenarios that included instances where a Court is not required to adjudicate on the basis of 'fair value' but simply has a jurisdiction to make an order that is just and equitable in the circumstances.

Had the Supreme Court in *Fong* needed to apply its comments to make a decision in relation to section 149, it might simply have concluded that a fair (meaning proper) process required, in a quasi-partnership situation (see item (c) of its process), where there was no oppression, that a valuation be carried out on an exchange value basis (see item (b) of its process), where the methodology to be applied needs to have regard to the fact that a wind up is the likely alternative (see item (a) of its process) and hence no discount for a minority stake would have been warranted.

It is arguable, therefore, that it will only be if there has been oppression, or the Court is otherwise empowered to make such order as the Court considers just and equitable, that a Court will have any reason, when assessing value, to have regard to general notions of fairness (objectively assessed) in its analysis.

While section 149 does not define fair value, other statutes give more guidance to what they require in relation to fair value. Section 112(2) of the *Companies Act* (dealing with minority buyouts) requires a fair and reasonable value for all the shares in each class to be allocated on a pro rata basis (effectively ruling out discounts for minority stakes or a lack of marketability). Rule 57(4) of the *Takeovers Code* (dealing with compulsory acquisition) is to a similar effect. The trend in legislation does tend to favour the 'equal treatment' rule and can be seen as a move against any tendency to attach discounts/premiums for differing rights, ie voting rights and/or the behavioural characteristics of the majority where the fundamental rights, ie rights to capital and dividends, are equal among all shareholders within a defined class of securities (see also the commentary in *Minority Buy-Outs* (Law Commission, R74, 30 July 2001) at [8] to [18]).

#### Trends

It is possible that in future the Courts will take a more liberal approach than has been taken in the past by valuers to the interpretation of fair market value in quasi-partnership cases, ie the Courts might see fair market value as not invariably or automatically requiring a discount if the application of a discount does not produce a real or intrinsic value. Courts might also emphasise consideration of the facts, circumstances, and evidenced behaviour in assessing intrinsic value.

Equally, outside of oppression cases where there is no requirement to adopt any particular standard, fair value is unlikely to have attributed to it the subjectivity, and general notions of 'fairness', that lawyers sometimes argue for in quasi-partnership cases.

So, with a fair market value test that does not appear to be as restrictive as some valuers see it, and a fair value test that does not appear to be as expansive as some lawyers would argue, it is not surprising that the Court of Appeal and the Supreme Court in *Fong* raised the question whether there is any real difference between the two standards.

For the reasons outlined above, there is scope for argument as to what if any difference there is between fair market value and fair value, and for the suggestion by the Supreme Court that the argument might in practice depend on the relevant legislative or contractual context.

#### Summary and Conclusions

Many people outside of the valuation profession see fair market value and fair value as interchangeable concepts.

Most valuers, however, view these concepts as amounting to two distinct valuation standards with prescribed calculation adjustments. For them, fair market value requires the valuer to assume a hypothetical open market, and usually involves a discount for a minority stake and/or perceived or established impediments to marketability. On the other hand, they see fair value as requiring valuers to determine a value that is just and equitable between the parties, and which usually does not involve a discount for a minority stake and/or impediments to marketability.

The Court of Appeal and the Supreme Court have now suggested that it may be arguable as to what, if any, difference there is between fair market value and fair value – the Supreme Court stating that they are "arguments which in practice may depend on the relevant legislative or contractual context".



An analysis of the case law indicates that the possibility raised by the Court of Appeal and the Supreme Court is not only arguable, but may be what a New Zealand Court will hold if it has to decide the matter in the future.

Both fair market value and fair value usually involve the valuer seeking to establish an exchange value. Where a hypothetical open market generally associated with fair market value provides the best approximation to reality and available opportunities, that will normally involve a discount for a minority stake and/or impediments to marketability. But a fair market value standard cannot mandate this outcome, particularly if a hypothetical open market is not the best approximation to reality. On the other hand, where a quasi-partnership relationship often associated with fair value is the reality, this involves determining a value that is just and equitable between the parties, and usually does not involve a discount for a minority stake and/or impediments to marketability. However, what is just and equitable normally means what a prudent person in the relevant position will be prepared to give and what the other person in that position would prudently be prepared to accept. In both cases, therefore, the valuer's role, where it is feasible to do so, is to determine an exchange value that is appropriate to the circumstances.

Perhaps fair market value and fair value are best seen as descriptions of value that assume a particular context in terms of the potential parties to the transaction and the manner in which they might be expected to engage – and not as predetermining how valuers assess value.

This does not mean that valuers should not continue to carefully assess the factors they have traditionally considered when deciding whether a discount applies. However, *Fong* (and others) provide a caution. Whether a discount applies to a valuation is likely, from a Court's perspective, to depend not on the label attaching to the measure of value, but on the legal and/or factual situation to which it is applied.

The case law indicates that the fair value of shares under section 149 of the *Companies Act* means a valuation of the shares made on an exchange value basis, which usually will not involve a discount for a minority stake and/or lack of marketability, but (unless oppression can successfully be pleaded under section 174 of the *Companies Act*) will also not involve factors extending beyond value that can only be justified by reference to fairness.

If fair value is interchangeable with fair market value, then the outcome should not depend upon which is used, but on the context (legal and/or factual situation) in which it is being applied. However, this cannot be assumed so long as varying terminology is used to describe the test of value and/or valuers see a distinction, and/or Courts feel a need to draw distinctions in particular cases. But where the application of the test does not accord with the law or the facts of the case, then there continues to be the potential for the valuation to be rejected.

As *Fong* shows, if the law mandates the test, and the parties apply what they perceive to be a different test, then that potentially involves an expensive mistake.

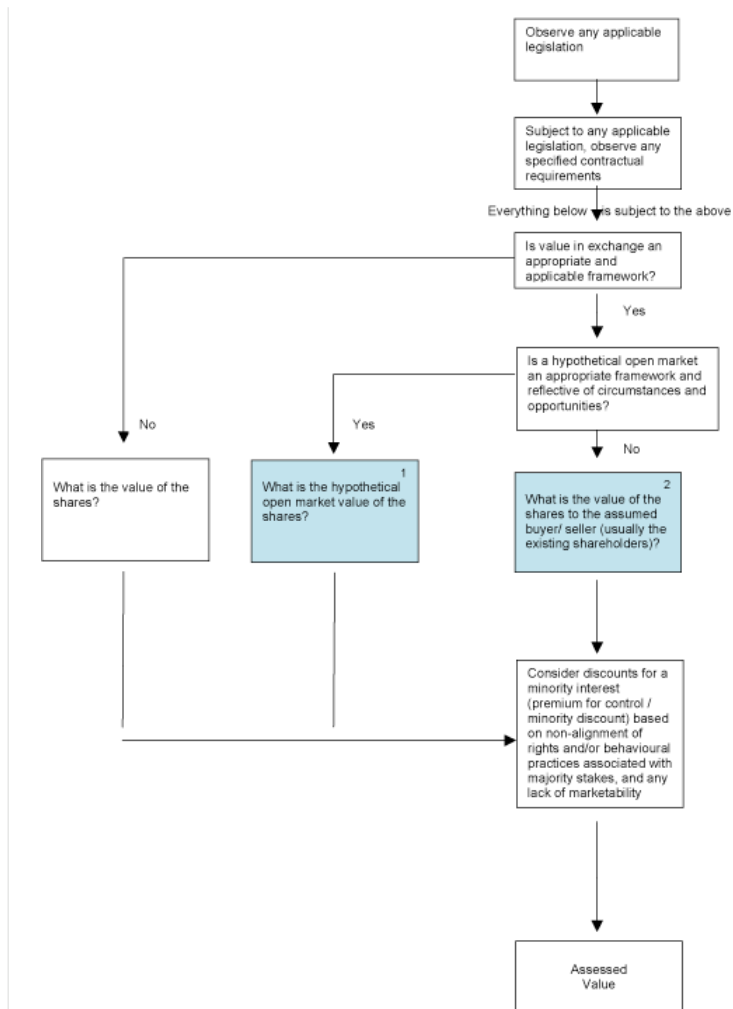
To put any alarm created by *Fong* in perspective, it needs to be appreciated that this case is only one of at least three incidences where valuations might not be accepted:

1. Cases where the Court considers the valuer has applied the wrong methodology, ie, it might have applied an assets methodology where an income capitalisation methodology is more appropriate;
2. Cases where the valuer applies the correct methodology but then applies a 'standard' and calculation approach, ie, fair market value or fair value, without sufficient regard to the facts, ie, 'fair market value' might, contrary to traditional expectations, not warrant a discount in the circumstances, or fair value might, contrary to traditional expectations, require a discount in the circumstances; or
3. Cases such as *Fong*, where the valuer is asked to apply a measure of value (described by the statute as "fair value") which does not warrant a discount in the circumstances, but applies a different measure of value, and it is obvious this has happened because of the terminology used and the meaning the valuer has given to that terminology.

Given the uncertainty that exists around the definitions of fair market value and fair value, there is a strong case for being more specific about the definition of value in shareholders agreements and constitutions. This is already happening in those instances where the wording makes it clear that there is to be a fair value that makes no discount for a minority stake and/or impediments to marketability. It is more difficult, however, to entrench what valuers have traditionally seen as being associated with fair market value ie a discount for a minority stake; first, because it may cause minority shareholders to refuse to sign; and secondly, because it is difficult to articulate the extent to which control affects value, and under what other scenarios a discount might apply. Nevertheless, there are examples of fair market value having been defined. An increasingly dangerous option is to simply provide for shares to be valued at fair market value and assume that a discount will be applied to a minority stake, particularly if the matter comes before a Court and the Court determines that an open market is not the appropriate analogy or context for the company concerned.

While theory suggests that minority stakes attract a discount that theory needs to be substantiated in individual cases. Even with a widely held company, which is efficiently run and with no difference in shareholder interests and behaviour there may be no evidence that the relevant stake warrants any discount to pro rata value. In such a company, shareholdings may be diversified and small, and the potential to aggregate shareholdings and derive benefits greater than the value reflected by pro rata values may not be likely. In a closely held company, the shareholders may effectively have negated any discount otherwise attracting to a minority stake, by enhancing the rights of the minorities (enhanced rights for 'minorities' can sometimes justify a premium). The limited range of buyers for the shares in a closely held company may be another factor that means that the relevant shares have a value to those buyers that should not be discounted. Hence, the theory that minority stakes attract a discount is only a starting point when considering individual cases.

A suggested guide for valuers embarking on the valuation process is set out below:



1. A

1. A value assessed in this context is usually characterised by valuers as being a fair market value.

2. A value assessed in this context is usually characterised by valuers as being a fair value.

Finally, irrespective of whether fair market value and fair value are distinctive standards or concepts, or simply interchangeable, neither can be determinative of the approach a Court takes in oppression cases. In such cases, the Court makes such order as it thinks fit, and where it orders a sale and purchase of shares it is not required to determine a price for the shares which is just and equitable between the parties. Rather, it has a discretion to do what is just and equitable, and in doing so, may make an order relating to the sale and purchase of shares – applying such measure of value as it considers appropriate.

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