SHERIFF APPEAL COURT

[2022] SAC (Civ) 8
EDI-CA32-18

Sheriff Principal D C W Pyle
Sheriff Principal M W Lewis
Sheriff Principal C D Turnbull

OPINION OF THE COURT

delivered by SHERIFF PRINCIPAL D C W PYLE

in the appeal in the cause

COULTERS PROPERTY LIMITED

Pursuer and Respondent

against

MARK ELLISON COULTER

Defender and Appellant

Pursuer and Respondent: A Smith QC, T Young, advocate; Lefevres
Defender and Appellant: Dean of Faculty (R W Dunlop QC); Addleshaw Goddard

4 February 2022

Introduction

[1] This is an appeal against the decision of the sheriff to dismiss the appellant's counterclaim. During the course of the appeal, the appellant amended his pleadings, to the extent that the arguments before the sheriff have been substantially superseded such that this court is considering the issue of relevancy *de novo*.

Background

[2] The appellant was the founder of Coulters Property Limited, the respondent. Its business is support services to Coulters Legal LLP which operates a residential estate agency and conveyancing business, principally focussed on the Edinburgh property market. In March 2016 following an investment by XT Property LLP the appellant's shareholding was reduced to 34%.

[3] In February 2018 the appellant was summarily dismissed as a director of the respondent. The circumstances of the dismissal are disputed, but its relevance is that it triggered a mandatory sale of the appellant's shares in terms of the respondent's articles of association. A dispute has arisen over the manner in which the shares were valued. In the principal action the respondent seeks payment of various sums arising from the alleged actings of the appellant, which resulted in his dismissal. The appellant counterclaims for the sum which he avers is the true value of his shareholding.

Articles of Association

[4] New articles were adopted by the respondent shortly after the investment by XT Property LLP. It is necessary to set out the terms of some of the articles in detail:

(a) Per article 6.1, a "Transfer Event" in relation to a member holding shares (such as the appellant) includes "that Member, being a Bad Leaver, ceasing to spend his full working time as an employee or director of or a consultant to the Company" and in such a case "a Member Majority notifying the Company within six months of the occurrence of such event… that such event is a Transfer Event in relation to that Member for the purposes of this article 6".

(b) Per article 6.2, upon such notification the "Member" shall be deemed to have served a "Compulsory Transfer Notice" in respect of all his "Compulsory Transfer Shares" and, per article 6.3, such shares "shall be offered for sale in accordance with the provisions of article 5 as if [such shares] were Sale Shares". In effect, the appellant's whole shareholding fell to be offered for sale, with or without his consent, to the majority shareholder. The basis upon which the appellant was deemed to be a "Bad Leaver" was (disputed) allegations that he unlawfully removed various sums of money from the respondent, of which his co-directors were unaware, that he instructed payments to his wife purportedly under a contract of employment which was a sham and that he obtained from the respondent payment of certain items of expenditure which were unauthorised.

(c) Per article 5, a member wishing to transfer his shares requires to give notice in writing to the respondent. This is termed a "Transfer Notice" and there are various requirements for it, most of which also apply to a "Compulsory Transfer Notice". In particular, both notices "shall constitute the Company [the respondent] as the agent of the Seller [the appellant] in relation to the sale of the Sale Shares" (article 5.1.3.5). Article 5 goes on to make provision for an agreed price for the shares, but in the event of no agreement being reached provision is made for the Member Majority to direct that the Transfer Price be the Fair Value determined in accordance with article 5.2.2 (article 5.1.4.3).

(d) Article 5.2.2 is in the following terms:

> "If the Seller and the Directors are unable to agree on the Transfer Price… or if a Member Majority directs… the Directors shall instruct the Auditors to determine and certify the Fair Value of the Sale Shares. The decision of the Auditors (who shall be deemed to act as an expert and not as an arbiter) shall

> be final and binding on the Members, save in the event of fraud or manifest error…"

The definition of Fair Value is as follows (article 1.1):

> "the price which the Auditors state in writing to be their opinion of the fair value of the Shares concerned, calculated on the basis that:
>
> (a) the Fair Value is the sum which a willing buyer would agree with a willing seller to be the purchase price for the Shares concerned on a Share Sale;
> (b) no account shall be taken of the size of the holding which the relevant Shares comprise or whether those Shares represent a majority or minority interest;
> (c) no account shall be taken if the fact that the transferability of the relevant Shares is restricted under these Articles;
> (d) if the Company is then carrying business as a going concern, it will continue to do so; and
> (e) any difficulty in applying any of the bases set out above shall be resolved by the Auditors as they, in their absolute discretion, think fit."

Thus, the articles of association provide in effect for the compulsory sale of the appellant's shares at an agreed price, failing which the other directors can insist upon the price being determined by the auditors. As will be seen, the appellant also attaches significance to article 5.1.3.5 which constitutes the respondent as the appellant's agent in relation to the sale.

The valuation

[5] The auditors, AAB, were duly instructed to value the appellant's shares. (In his pleadings the appellant disputes that they were in fact the auditors at the relevant time. Senior counsel did not press that point. We have assumed, therefore, that that is no longer in dispute.) They valued them at £74,949. In reaching that figure, they adopted an asset based valuation which, avers the appellant, is suitable and appropriate for a company which is insolvent or is likely to become insolvent, rather than one which is a going concern. The appellant goes on to aver that the respondent was neither insolvent nor likely to become

insolvent. The true value on a going concern basis was £506,800 for which sum the appellant counterclaims. He avers that at the material time the respondent was trading profitably and continues to trade.

The pleadings

[6] Relying upon article 5.1.3.5, the appellant avers that concluding the contract, that is the transfer of the appellant's shares to the other pre-existing members, at a price other than the Fair Value properly calculated "is in breach of contract [of agency] with the selling shareholder [the appellant]" (Statement of Fact 3). He goes on to aver that the auditors "fell into manifest error and separately in defiance of their instructions" and that the "manifest error was one which no auditor would have made, as it was based upon a lack of investigation" (Statement of Fact 4).

Submissions

[7] Senior counsel for the appellant submitted that the pleadings in their now amended form set forth a straightforward case of breach of the agency contract. The respondent's breach was to proceed with the transfer of the shares, contrary to the appellant's interest, in defiance of its mandate which has to be applied strictly where it is specific (MacGregor, *The Law of Agency in Scotland* (2013) paras 7-01 – 7-02). If the auditors fail to fix a fair value as defined, the respondent as agent had no authority to transfer the shares (*Gilmour* v *Clark* (1853) 15 D 478(at p 480)). In that circumstance it is unnecessary to look behind the valuation. Nor are relevant the various authorities on the question of whether reduction be craved or not or on the extent to which it is open to parties to look behind the terms of the valuation certificate. The authorities on the latter point are cases where the dispute is

between the seller and the purchaser; not as here a dispute between the agent and the principal. The contract provides that a document be produced – the valuation. Given that the valuation is manifestly in error in that it does not accord with the instruction of the respondent as agent for the appellant, there is no document which the respondent was required to act upon.

[8] For the respondent, the Dean of Faculty made three submissions. First, the contract does not say what the appellant wants it to say. The articles of association are mandatory in their terms; the directors had no choice but to proceed to instruct the valuation and to act upon it once received. There was no duty upon the directors to supervise the auditors in the execution of their function. If the directors had an implied duty under the agency contract to seek clarification from the auditors about any aspect of their valuation or its reasoning the appellant should have averred that. The appellant's proposed construction of the articles defies business common sense (*Ashtead Plant Hire Co Ltd* v *Granton Central Developments Ltd* 2020 SC 244, para [16]). It would be disproportionate to place on the respondent a burden effectively to guarantee the work of the auditors, particularly where, as here, the respondent does not have their expertise. Secondly, the appellant is inviting the court to depart from the terms of the contract by in effect placing a value on the shares when the contract says that this is exclusively a matter for the auditors (*Norwich Union Life Insurance Society* v *P&O Property Holdings Ltd* [1993] 1 EGLR 164, at p 166). The fact that this case is about damages for an alleged breach of contract makes no difference – the court in effect is being invited to fix a value of the shares. Thirdly, the appellant's original case included a crave for reduction *ope exceptionis*. That was abandoned. His case as now pled in effect asks the court simply to ignore the valuation. That cannot be allowed. The valuation stands until reduced (*Brown* v *Hamilton District Council* 1983 SC (HL) 1 at p 45-46; *Eastern Motor Company Limited* v *Grassick*

& Ors [2021] CSIH 67, para [62]). The appellant has a remedy. At an earlier stage he could have protested the valuation by way of judicial review or even by reduction in the sheriff court. But he still has the right to proceed with a claim against the auditors in delict (*Arenson* v *Casson Beckman Rutley & Co* [1977] AC 405, at p 442).

Discussion

[9] The progress of this action has taken many twists and turns. But as matters now stand, the appellant imperils his case on a simple proposition: the contract between the parties is one of agency, the express terms of which are set out in the articles of association. There is also an implied term that the agent must act only in terms of the mandate – the instructions. We accept that as a proposition in law; indeed it is perhaps a trite one. The appellant goes on to aver that the respondent was in breach of the contract of agency by proceeding with the share transfer in the face of what is averred to be a manifest error by the auditors. The appellant's proposition moreover is that because of the manifest error there is in effect no valuation in terms of the contract, such that the respondent required to act upon it.

[10] It is in our opinion important to emphasise the stark nature of the implied term which it is averred was breached. We can imagine many situations where there would be other more complicated implied terms. If, for example, a solicitor for a purchaser of heritable property failed to notice an error in a title deed such that the seller was incapable of transferring a valid and marketable title, the solicitor would be in breach of an implied term of the contract – indeed would in certain circumstances also be liable in delict. In other words, certain standards of professional care and responsibility would be implied in the contract. As a general rule, at least in the context of agents in a more general commercial

sense, in carrying out his undertaking an agent must use such care and diligence as would be used by a man of ordinary prudence in the same line of employment (Bell's *Commentaries* I 516). Another ordinarily implied term is that as the agent is in a position of trust he may not use his power directly or indirectly to benefit himself (eg *Liverpool Victoria Legal Friendly Society* v *Houston* (1900) 3 F 42). Indeed, the expression, a conflict of interest, is an illustration of that underlying fiduciary relationship. But none of these other implied terms is relied upon by the appellant.

[11] Instead, the appellant relies upon a bare averment that, standing a manifest error in the valuation, the respondent was bound to treat it as irrelevant for the purposes of its obligation to proceed with the transfer. In our opinion, the appellant's case is misconceived. We have reached that conclusion for the following reasons:

1. We were invited, despite the contradictory position adopted by senior counsel, to follow the well-known line of authority on challenges to certificates by valuers. While we accept that the authorities are of assistance in identifying manifest error or a failure to follow instructions, they are not particularly relevant to the nub of the issue in this case, at least insofar as pled by the appellant, which is whether or not the respondent was obliged to scrutinise the auditors' certificate. Senior counsel expressly disavowed such an obligation, but that just raises the issue of the extent to which the respondent's directors had to consider it at all. There is, in our view, an inherent contradiction in the appellant's submission: if the directors were not to scrutinise the certificate, what were they supposed to do? If, for example, the valuation was for a figure of, say, £2 million or for a figure of, say, £1, were they to draw that to the intention of the interested parties – the respondent and the other members? And what if, as we suspect was the case, the directors were also members

or at least had a financial interest in the members and therefore were faced with a conflict of interest? None of this makes commercial common sense.

2. We agree with the Dean of Faculty that it is not open to us to allow this case to pass the test of relevancy without a route whereby the auditors' certificate can be formally put to one side. The general rule is that where a deed is *ipso jure* null the nullity may be pleaded by way of exception, but where a deed is merely voidable an action of reduction is necessary (Watson (ed) *Bell's Dictionary and Digest of the Law of Scotland* (7th ed, 1890) p 893. But in theory where a contract is null *ab initio* there is no need for reduction at all. A "void contract" is a contradiction in terms in that if it is void by definition there can be no contract in the first place – what Gloag describes as a "seeming contract" (*Gloag on Contract*, 2nd ed, p 531). In practice, it would be unusual not to seek reduction (whether by reduction or reduction *ope exceptionis*, although the difference may not be significant in modern practice (*Eastern Motor Company Limited* v *Grassick & Ors*, para [48] *et seq*)); caution would suggest that reduction should always be sought to avoid any doubt. There is support for that approach in *Sadler* v *Webster* (1893) 21 R 107 where the minutes of a trade incorporation were reduced "in order that there be no dubiety… as to their essential nullity." Nevertheless, we accept that as a matter of strict competency if the auditors' report is void – a nullity - the appellant did not require to seek reduction. The distinction between void and voidable is difficult to define. In general, the authorities merely illustrate occasions where there is a nullity *ab initio* in contrast to those where reduction is required. For present purposes, it might usefully be said that where a contract is *ex facie* regular it is voidable, not void. There will be exceptions to that of course, such as the incapacity of one party to contract or matters

such as fraud, facility or circumvention or indeed illegality as a matter of public law. But the definition is useful in the present circumstances where the auditors have produced a report which is *ex facie* regular in form. In particular, the auditors record accurately what the instruction was and implement it by giving the valuation which was sought. It is only when one considers the detail of the report and the auditors' reasoning does the question of nullity arise. In our opinion, that means that for the matter to be properly before the court the appellant required to crave reduction or reduction *ope exceptionis*. That he has not done so means of itself that the counterclaim is irrelevant. In reaching that conclusion, we recognise that the authorities accept that an element of pragmatism ought to be applied depending upon the circumstances - and in the modern context of commercial actions (albeit this is not one) an overzealous reliance on the rules of pleadings should be avoided. (See, eg, in the context of declarators, *Duke of Argyll* v *Campbeltown Coal Co* 1924 SC 844) Nevertheless, we agree with the Dean of Faculty that where, as here, the directors had to instruct the valuation and on its receipt implement its terms, the position is analogous to the position in *Brown* v *Hamilton District Council* (accepting that it is a case about public, not private, law) where the council was both the decision-making authority and the decision-implementing authority. The decision was one made by the auditors, but it is the respondent which instructed them and it is the respondent which has to implement their valuation. The respondent is entitled to know whether the valuation should be set aside or not.

3. In any event, even if the question of the nullity of the auditors' valuation was properly before the court, we do not consider that on his pleadings the appellant has satisfied the test of manifest error or failure to follow instructions. On the latter, the

Inner House in *Eastern Motor Company Limited* v *Grassick & Ors* approved the dictum of Lord Hoffmann LJ (as he then was) in *Mercury Communications Limited* v *Director General of Communications* [1994] CLC 1125; [1996] 1 WLR 48, HL (E):

> "So in questions in which the parties have entrusted the power of decision to a valuer or other decision-maker, the courts will not interfere either before or after the decision. This is because the court's views about the right answer to the question are irrelevant. On the other hand, the court will intervene if the decision-maker has gone outside the limits of his decision-making authority.
>
> One must be careful about what is meant by 'the decision-making authority'. By 'decision-making authority' I mean the power to make the wrong decision, in the sense of a decision different from that which the court would have made. Where the decision-maker is asked to decide in accordance with certain principles, he must obviously inform himself of those principles and this may mean having, in a trivial sense, to 'decide' what they mean. It does not follow that the question of what the principles mean is a matter within his decision-making authority in the sense that the parties have agreed to be bound by his views. Even if the language used by the parties is ambiguous, it must (unless void for uncertainty) have a meaning. The parties have agreed to a decision in accordance with this meaning and no other. Accordingly, if the decision-maker has acted upon what in the court's view was the wrong meaning, he has gone outside his decision-making authority. Ambiguity in this sense is different from conceptual imprecision which leaves to the judgment of the decision-maker the question of whether given facts fall within the specified criterion."

On the question of what constitutes a manifest error in the present context, the Inner House said,

> "… that this requires there to be a glaring mistake that jumps off the page. We respectfully agree with Simon Brown LJ (as he then was) in *Veba Oil and Trading GmbH v Petrotrade Inc ("The Robin") [2002] CLC 405 at paragraph 33* that for a manifest error the defenders must be able to show 'oversights and blunders so obvious *and obviously capable of affecting the determination* as to admit of no difference of opinion'. A mere difference of opinion cannot be described as a 'blunder'."

In Statement of Fact 4.1, the appellant avers that as the company was not insolvent and was not likely to become insolvent the use of the asset based valuation basis was manifestly incorrect and disconform to the requirements of calculation

contained in the articles of association. In response to the respondent's answers the appellant states:

> "Admitted, under explanation following, that [the auditors] indicated that there was 'significant uncertainty over the Company's future earnings potential' and 'with doubt over its ability to continue trading as a going concern' but under explanation following… The discretion afforded to [the auditors] in the 'applying the bases' of valuation does not extend to a discretion to utilize one method over another. That is especially so in the event that a manifest error occurs in the selection method."

In our opinion, even if this criticism of the auditors is warranted it is not such that it can be said that they have not followed the instruction - in the Hoffmann sense that they "acted upon what in the court's view was the wrong meaning, [they have] gone outside [their] decision-making authority". Nor can it be described as an obvious blunder. The auditors' report is incorporated into the respondent's answers and parts of it are quoted in the appellant's statement of facts. It was before this court, albeit not directly referred to by counsel. When one considers its terms it is apparent that the auditors had to grapple with the prospect that the existing contract between the company and the LLP might not continue. It was for that reason that they considered that asset based valuation was appropriate. That is no more than an example of what the articles of association provide, namely a "difficulty in applying any of the bases set out above" and which are to be "resolved by [the auditors] as they, in their absolute discretion, think fit". The appellant makes no averments to contradict the factual circumstances which the auditors decided were relevant in deciding whether the company would continue to trade as a going concern. Accordingly, there are no issues of fact which the appellant seeks to be resolved on this question, such that a proof before answer might be required.

4. As with any commercial contract, the role of the court is to interpret it in a manner which properly reflects the wishes of the parties to it. Ultimately, it all comes down to construction of the terms of the contract under which the expert was appointed to act (*Premier Telecommunications Group Ltd* v *Webb* [2016] BCC 439). The terms are clear: the respondent through its directors was bound to instruct the auditors for the valuation. The respondent was bound to transfer the shares for the value fixed by the auditors. The respondent did so. That was in accordance with the mandate which it was bound to implement.

Decision

[12] At this stage the test of relevancy is even if all the averments are proved the action must necessarily fail (*Jamieson* v *Jamieson* 1952 SC (HL) 44). We are satisfied that the appellant's counterclaim fails that test and falls to be dismissed.

[13] Expenses follow success and we certify the appeal as suitable for the employment of senior counsel.