[2015] UKFTT 0220 (TC)

**TC04413**

**Appeal number: SC/3048/2003**
**SC/3049/2003**

***CAPITAL GAINS TAX – gifts of shares in an unquoted company – shareholdings of 51% and 9% - TCGA 1992, s 17, s 272 and s 273 – experts adopting different valuation methodologies and concluding on very different valuations – determination of values by tribunal***

**FIRST-TIER TRIBUNAL**
**TAX CHAMBER**

**BRIAN FOULSER**
**MRS DOREEN FOULSER** **Appellants**

**- and -**

**THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS** **Respondents**

**TRIBUNAL: JUDGE ROGER BERNER**
**MRS HELEN MYERSCOUGH**

**Sitting in public at The Royal Courts of Justice, Strand, London WC2 on 21 January 2015 (reading day) to 30 January 2015**

**Simon Myerson QC and Hannah Lynch, instructed by Montpelier Group (Tax Consultants) Limited, for the Appellants**

**Michael Gibbon QC and Fiona Dewar, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents**

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DECISION

1. This decision concerns the determination of the market value of shares for capital gains tax. The shares were in a company called BG Foods Limited ("BG Foods"). Each of the appellants, Mr Brian Foulser and his wife, Mrs Doreen Foulser, made gifts of their shares in BG Foods to companies held within insurance bonds. Those gifts, as it has turned out, were disposals chargeable to CGT. By virtue of s 17 of the Taxation of Chargeable Gains Act 1992 ("TCGA") the gains fall in each case to be calculated by reference to the market value of the shares disposed of. In Mr Foulser's case the shareholding amounted to 51% of the share capital of BG Foods; Mrs Foulser's shareholding was 9%.

2. A great deal of time has elapsed since Mr and Mrs Foulser made their gifts, as long ago as 24 November 1997 ("the valuation date"). There has been much litigation between the parties. First, there was the decision of the special commissioner, Dr Avery Jones, released on 28 February 2005, dismissing in principle the appeals of Mr and Mrs Foulser against amendments to their self assessment returns: see [2005] STC (SCD) 374. The claims by Mr and Mrs Foulser that hold over relief under s 165 TCGA applied to their gifts of shares was rejected. That decision was upheld by the High Court [2006] STC 311 and the Court of Appeal [2007] STC 973.

3. The result was that the amount of the liability of Mrs and Mrs Foulser to CGT fell to be agreed or determined by reference to the market value of their respective shareholdings at the valuation date. No agreement was possible; indeed as will be seen the parties remain very far apart on this issue. Consequently, the question of valuation in the ongoing appeals came before this Tribunal, as the successor to the special commissioners. The hearing in that respect, before Judge Avery Jones, commenced on 28 September 2010. But after only a single day of oral evidence the hearing was adjourned in rather extraordinary circumstances. As those circumstances are described elsewhere (see, for example, *Foulser and another v Revenue and Customs Commissioners* [2013] STC 917), we shall not repeat them here, but the proceedings which ensued as a result, along with a further preliminary issue considered by this Tribunal as reported at [2014] UKFTT 483 (TC), have further contributed to the length of time these appeals have taken to reach this point.

## The approach to evidence of fact

4. The lapse of time between the valuation date and this hearing is of more than academic interest. Although the issue between the parties is one of valuation, and the principal evidence we have in that respect is experts' opinions adopting different approaches and coming to different conclusions, those opinions have included positions adopted by each of the experts on certain factual matters. As regards the evidence of witnesses of fact, the parties were agreed that the relevant principles to be followed are those most recently summarised in *Gestmin SGPA SA v Credit Suisse (UK) Limited* [2013] EWHC 3560 (Comm).

5. In *Gestmin*, at [15] to [22], Leggatt J set out an analysis of the difficulty faced by the courts in making findings of fact based on witnesses' recollection of events which have occurred several years earlier. Although it was obvious that memory is fallible, and especially unreliable when it comes to recalling past beliefs, the very process of civil litigation was itself apt to interfere with the memory of witnesses, and to subject those memories to powerful biases. A witness's memory of events could as a result be based increasingly on material recorded in the witness's statement and other written material and later interpretations of it rather than on the original experience of events. There was nothing to be gained from attempting to elicit from a witness whether their evidence was genuine recollection or a reconstruction of events. The very nature of memory blurs that distinction.

6. At [22], Leggatt J set out the best approach in these circumstances:

> "In the light of these considerations, the best approach for a judge to adopt in the trial of a commercial case is, in my view, to place little if any reliance at all on witnesses' recollections of what was said in meetings and conversations, and to base factual findings on inferences drawn from the documentary evidence and known or probable facts. This does not mean that oral testimony serves no useful purpose – though its utility is often disproportionate to its length. But its value lies largely, as I see it, in the opportunity which cross-examination affords to subject the documentary record to critical scrutiny and to gauge the personality, motivations and working practices of a witness, rather than in testimony of what the witness recalls of particular conversations and events. Above all, it is important to avoid the fallacy of supposing that, because a witness has confidence in his or her recollection and is honest, evidence based on that recollection provides any reliable guide to the truth."

7. *Gestmin* was a case in the Commercial Court, and Leggatt J was careful to confine his remarks on the best approach to be adopted to commercial cases (although the general thrust of his comments is clearly of wider import). But the nature of the dispute before us is commercial, and there was no argument to the contrary. We have, accordingly, adopted that approach in making our findings of fact.

**Evidence of fact**

8. We heard oral evidence from five witnesses of fact, each of whom had made witness statements in connection with the 2010 hearing. Those witnesses were:

(a) Mr Foulser;

(b) his son Grahame Foulser (whom we shall describe as Mr Grahame Foulser, or Grahame), who at the material time was production director of the dairy product facility of Devon Desserts Limited, a wholly-owned subsidiary of BG Foods;

(c) Paul Hemming, an accountant who at the material time was employed by Arthur Andersen Corporate Finance (he became a partner there in 2001);

(d) Donald Shipp, the auditor of BG Foods at the relevant time; and

(e) Ceryl Johns, who was at the material time a financial adviser of Mr and Mrs Foulser.

9. In the cases of Mr Hemming and Mr Shipp, those witnesses had given evidence at the 2010 hearing before it was adjourned. We had transcripts of that evidence. As this hearing strictly was a continuation of the 2010 hearing, albeit with a new panel (Judge Avery Jones having retired in the meantime), the evidence given by Mr Hemming and Mr Shipp to us and Mr Gibbon's cross-examination of those witnesses focused on a recapitulation of material parts of the earlier evidence given in 2010.

10. As well as the witness statements prepared for the 2010 hearing, we had witness statements of Mr Foulser and Mr Shipp from 2003, and affidavits of Mr Hemming and Mr Johns made in 2005, all of which had been prepared for the appeal hearing before the special commissioner in 2005. We note, however, that in 2005 the special commissioner had refused to admit Mr Hemming's affidavit in evidence.

11. In addition to witnesses who gave oral evidence before us, we had additional witness statements of Mrs Foulser, Juliet Foulser (Mr and Mrs Foulser's daughter) and Edward Gittins, who had advised Mr and Mrs Foulser on the tax effects of the gifts of shares in 1997. Each of those statements had been made in 2003 in relation to the 2005 hearing. At that hearing, Mr Foulser, Mr Shipp and Mr Gittins gave oral evidence; Mrs Foulser had started to give evidence at that hearing, but her cross-examination had not been completed because of ill-health.

12. Further, we had witness statements from a number of individuals, collectively described as "industry witnesses", whom HMRC did not call for cross-examination. Those statements, all of which were prepared for the purpose of the 2010 hearing, were made by:

(a) Jean Luc Aubagnac, whose French family dairy business was a supplier to BG Foods;

(b) Cyril Freedman, a corporate financier who at the material time was executive chairman of S Daniels plc ("Daniels"), a major supplier to BG Foods and Devon Desserts, whose evidence principally related to an indicative offer made by Daniels for BG Foods in 1998;

(c) Timothy Henniker-Parker, who has experience of the dairy industry at many levels and who in 1994 acquired Loseley Dairy Products Limited from Booker plc;

(d) Jean-François Fortin, Directeur General of Les Maîtres Laitiers du Contentin, in Northern France, suppliers to BG Foods; and

(e) Tim Mead, the owner and managing director of Yeo Valley Farms (Production) Limited, which manufactured yoghurt for BG Foods which was exported by BG Foods to France under the Kool brand.

13. As well as the witness evidence we had a number of bundles of documents.

## Findings of fact

14. Although the question before us is one of valuation, each of the experts who provided opinions dealt with factual issues in their reports, and made inferences from facts in forming their views on the proper valuations of Mr and Mrs Foulser's shares. We shall describe the evidence of the experts in more detail below, but Mr Glover, instructed by HMRC, relied on certain factual conclusions for one particular element of his valuation, and Mr Spence confirmed that if certain factual conclusions he had reached were not found to be correct, that would have a material effect on his valuation.

15. For this reason, it is with the findings of fact that we start.

*BG Foods Limited*

16. Following a career in frozen and chilled foods culminating in being managing director of Chambourcy Dairy Products, a division of Nestlé, Mr Foulser founded BG Foods in 1984, with Mrs Foulser and two other directors. Its early business model was to assist major multiple food retailers, essentially the major supermarket chains, to distinguish themselves from the competition through the provision of apparently own-branded products. Those major retailers were the customers of BG Foods. In order to provide those customers with products, BG Foods entered into exclusive supply contracts with French branded producers of dairy products. BG Foods provided a complete service to its customers, including sales, marketing, product, warehousing and international transport to collect from the factories of the French suppliers, together with UK distribution to the retailers' central distribution centres and full administrative support.

17. As Mr Foulser explained in his 2010 witness statement, at first BG Foods was perceived as a simple wholesaler, or "middle man". However, its business model was different. Suppliers were contracted to meet the requirements of BG Foods, which reflected the demands of BG Foods' customers, but in order to maintain those supply contracts it was essential that BG Foods performed by continually increasing sales, underwriting packaging ordered on its behalf and making relevant capital investments in suppliers' factories.

18. As Mr Foulser emphasised, the nature of BG Foods' business made the personal relationships with both suppliers and customers of crucial importance. He regarded those relationships as his personal responsibility, although as the business expanded in the 1990s sales managers were appointed to maintain and develop the buyer contact relationships. Mr Foulser continued, however, to maintain his own personal contacts at senior board level.

19. The perception of BG Foods as a mere wholesaler was one of the reasons given by Mr Foulser for taking the decision in 1989 to expand into its own production of dessert products. It did this by acquiring, out of administration, the business of a company, Devon Desserts Limited, and constructing its own new purpose built 25,000 square feet manufacturing plant on Newton Abbot.

*The minority interest of Mr Ashness and 3i*

20. In the 1990s, as BG Foods continued to develop both in scale and reputation, Mr Foulser received a number of unsolicited approaches in relation to possible takeovers and mergers. A formal offer was received in 1993/94 valuing the entire share capital of BG Foods at £10 million, but Mr Foulser did not wish to dispose of his shares and the offer was withdrawn. Later other approaches were made. We were shown an example by way of a letter of 16 April 1997 from Mr Foulser to the managing director of Geest Prepared Foods giving an indication of performance for the year to 30 April 1997 and stating that any consideration of the business would have to be as a single entity.

21. By 1997, a 40% interest in BG Foods was owned by Mr Richard Ashness and 3i plc. It was in 1995 that Mr Foulser was approached by Mr Ashness, a former director of one of BG Foods' clients, initially with a view to acquiring the whole company with the backing of 3i. Following discussions in which Mr Foulser indicated that he did not have an immediate interest in selling his shares, Mr Ashness wrote to Mr Foulser on 24 March 1995 offering to purchase the business in two stages, with the 40% minority being acquired initially for a consideration of £4 million and the 60% majority, up to six months later, for £12 million. Mr Ashness, with Mr Foulser's approval, negotiated with the holders of the 40% of the shares in the company that were not owned by Mr and Mrs Foulser. That 40% holding was acquired by Mr Ashness and 3i, through an acquisition vehicle, KEL-X5 Limited ("KEL"), in two tranches in January and April 1996 at a total price of £3.66 million.

22. At the same time Mr Foulser had been discussing with Mr Ashness a mechanism to enable Mr and Mrs Foulser to exit the company when they chose to do so, on the basis of a formula giving a price of £12 million for their combined 60% holding based on the 1995/96 forecast profit of BG Foods. A memorandum and heads of terms agreement was produced to make provision for this. However, this was not finalised at the time of Mr Ashness' acquisition of the 40% stake, and Mr Ashness subsequently decided not to proceed with it. This created a tension between Mr Foulser and Mr Ashness, and a number of proposals were made by Mr Foulser in relation to a possible sale of the 60%. But no agreement could be reached on a formula reflecting improvement in the performance of the company. In the meantime, neither Mr Ashness nor any other representative of KEL was appointed to the board of BG Foods, and the company ceased paying dividends. (Dividends of £6.50 per share were paid for 1995/96, but no dividends were paid for 1996/97 and 1997/98.)

23. As a result of the failure of Mr Foulser and Mr Ashness to reach agreement, 3i was caught between these two positions. As appears from a note of a meeting at the offices of Mr Foulser's solicitors, Rooks Rider, on 13 October 1997, at which 3i was represented and Rooks Rider represented Mr Foulser, 3i itself had at one stage following January 1996 offered over £16 million to Mr Foulser (which we infer was for his shareholding and that of Mrs Foulser), which the note records was several £millions beyond what Mr Ashness was prepared to pay. Among the options discussed at the meeting was the removal of Mr Ashness from involvement with BG Foods, but the continued involvement of 3i. This was suggested as a possible way in

which 3i could help Mr Foulser realise some equity in order to "hand on the business to the next generation".

24. The meeting also discussed a possible sale to Mr Foulser of the 40% shareholding of KEL. Mr Foulser had indicated that a price of £3.66 million would be acceptable to him, but understood that 3i would be looking for more, and it was conceded that Mr Foulser had earlier agreed £4.5 million. 3i referred to a value in the region of £10 million, based on assumed after tax profits of £2.2 million and an historic post tax multiple of 12, giving a value for the whole company of £25 million, but accepted that there would be a discount (normally about 25%) for a minority holding. (That we infer would equate to approximately £7.5 million for the 40% holding, which we find was also understood by Mr Foulser as he later – in a meeting with his solicitors on Project Frostie (which we will discuss below) on 27 January 1998 – reasoned that KEL's sale price as part of that project would be between £7-8 million.) It was agreed that Rooks Rider would discuss with Mr Foulser whether he would be willing to contemplate having 3i as a direct shareholder, a revised price for the minority above £4.5 million, and (subject to signing a confidentiality agreement) the provision to 3i of further information to allow them to assess the value of BG Foods.

25. The following day, 14 October 1997, Mr Jeremy Whiteson of Rooks Rider wrote to Mr Foulser enclosing a copy of the note of meeting, and asking him in particular for his observations on the suggested revision of the offer price for the minority. Mr Foulser replied on 21 October 1997, saying that he was not willing to increase the offer beyond £4.5 million. He regarded 3i's valuation as contentious and as "positioning". He suggested that the negotiations on price might be assisted by the release of the then current management accounts, as August and September had been extremely poor trading months due to factory inefficiencies and record wastage levels.

26. Subsequent correspondence shows that Mr Foulser and 3i remained apart on way forward, both as regards mechanics and as regards price. After Rooks Rider had put Mr Foulser's position to 3i in a letter dated 29 October 1997, 3i responded on 6 November 1997 to say that they wished to sell only 10% and retain 30%, and that the price would need to be much nearer their end of the pricing spectrum. In reply, Rooks Rider, for Mr Foulser, wrote to 3i on 17 November 1997 to say that such a proposal was not acceptable, and that Mr Foulser's preference was to acquire the whole 40% stake and that, on the basis that 3i had indicated that they would not accept an offer of £4.5 million, 3i were invited to put forward a realistic suggested price.

## Project Frostie

27. Project Frostie (or Frosty) was the codename given to a proposed acquisition of BG Foods by certain parties headed by a Mr Nigel Kingston, and represented by Arthur Andersen. That project involved an indicative offer for the 60% shareholding of Mr and Mrs Foulser by a Newco to be formed around Mr Kingston, as putative managing director, and equity-financed by Kleinwort Benson Development Capital, along with debt finance.

28. For reasons we shall explore, the project involving Mr Kingston did not proceed to completion. The codename Project Frostie (or Frosty) was also used for an acquisition by a different Newco, backed by 3i, of the whole of the share capital of BG Foods for a total consideration of around £36 million, of which some £27.3 million was attributable to the 60% shareholding formerly held by Mr and Mrs Foulser, which they had gifted to companies held by Irish Life under the insurance bond. Mr Kingston was not involved in that acquisition. His place as putative managing director had been taken by Mr Christopher Stainow.

*Mr Kingston's proposals*

29. The proposals that, in relation to Mr Kingston, became Project Frostie emanated from work done by Arthur Andersen Corporate Finance in reviewing some of 3i's private equity portfolios, in the course of which they, and in particular Mr Hemming from whom we heard evidence, had identified BG Foods as an object of interest, because of the minority interest held by 3i.

30. This led Mr Hemming to make an unsolicited call to Mr Foulser. The precise timing of that call is unclear, but it must have been some time before 7 July 1997. During that initial call, Mr Hemming recalled that Mr Foulser was quite open, and obviously used to receiving such approaches. However, Mr Hemming's suggestion of a face to face meeting was met with Mr Foulser saying that he would not wish to take matters any further unless there was an offer of £26 million for the 60% interest in the company. Mr Foulser said that this was a figure he had essentially "plucked out of the air" in order to discourage any approach that was not serious. This, we find, was how Mr Hemming regarded it.

31. That was not, however, the end of the matter. Mr Hemming subsequently contacted Mr Foulser again to say that he had identified a possible purchaser, whose identity at that stage Mr Hemming was unable to reveal (but who was Mr Kingston), at the figure which Mr Foulser had mentioned, and to seek some basic financial information. On the basis that this was limited, Mr Foulser agreed to provide it.

32. All this evidently took place before 7 July 1997, as on that date Mr Kingston wrote to Mr Foulser in the form of a confidentiality letter in order that Mr Foulser would provide further information in relation to BG Foods.

33. Although it is unclear what information was provided to Arthur Andersen at this time, it is clear that some confidential information was passed over. There was some further engagement between Mr Foulser and Mr Hemming in the period between July and October 1997, but there is no documentary evidence of it, and it appears to us to have been quite limited. We make that finding because it was only on 16 October 1997 that Mr Foulser wrote to Mr Hemming by fax to send him balance sheets for BG Foods and Devon Desserts Ltd, product group gross margin, cash flow, details of capital investment plans and profit and loss management accounts for September 1997. Mr Hemming said in evidence, and we accept, that at this stage he would not have sought information concerning each month, and so it could not be assumed that management accounts for months before September 1997 had been

received. We also accept his evidence that there were periods between July and October 1997 when nothing was happening.

34. The information provided by Mr Foulser was used by Mr Hemming to work on some high-level modelling and to have preliminary discussions on an initial indicative offer with a potential funder, which we infer was Kleinwort Benson. The aim was to establish, at that high level, that a price of £26 million which Mr Foulser had indicated he was looking for could be justified in terms of return.

35. That indicative offer was made by Arthur Andersen on behalf of Mr Kingston by letter dated 29 October 1997 addressed to Mr Foulser. It was headed "subject to contract" and described as an indicative offer for Mr and Mrs Foulser's 60% shareholding, conditional on agreement being reached for the purchase of the remaining 40%. The consideration indicated was £26 million in loan notes. The acquisition vehicle was to be a Newco formed around Mr Kingston, who was to be the managing director. Newco was to be equity-financed by Kleinwort Benson.

36. The indicative offer was made on a number of assumptions:

(a) profit before tax for the year ending 30 April 1998 would be at least £4.7 million, as forecast in the BG Foods Group Long Term Plan;

(b) the business would have sufficient cash on completion to meet the capital expenditure costs of the construction and commission of equipment for the new production plant, estimated at that time at £4 million, including a contingency of £700,000;

(c) all excess cash above that required to satisfy (b) would be free for distribution to the shareholders, net of any advance corporation tax payable on such distributions;

(d) there was no long-term debt in the business except the mortgage estimated at £300,000; and

(e) that KEL owned a 40% shareholding in BG Foods and that Mr Kingston and his team could negotiate independently with 3i and the other investor.

37. The indicative offer was also subject to what were described as "material terms and conditions". These included satisfactory due diligence and approval of equity and debt providers, along with agreement of legally binding documentation, including warranties, indemnities and non-compete clauses.

38. As we have summarised earlier, the indicative offer arrived at a time when Mr Foulser was himself actively pursuing another possible transaction, namely the acquisition by him of the minority interest in BG Foods. Matters in that regard had stalled, however, with Rooks Rider's letter of 17 November 1997. A meeting concerning Mr Kingston's approach took place on 1 December 1997 between Mr Foulser and Mr Shipp and Mr Hemming, following which, on 3 December 1997, Mr Hemming wrote to Mr and Mrs Foulser to reiterate the indicative offer made on 29 October 1997, with certain amendments, and to seek agreement to a period of

exclusivity from 3 December 1997 to 2 January 1998. That agreement was signed by Mr and Mrs Foulser on 5 December 1997.

39. One of the amendments from the indicative offer was that there was to be a mechanism for price adjustment should the profits for the year to 30 April 1998 deviate from those assumed in the indicative offer, but within an agreed range only. Another was that Mr Kingston would consider, as prompted by Mr Foulser, increasing the offer.

40. At this stage, 3i were aware of the approach made by Mr Kingston and Arthur Andersen. They had not, however, expressed any intention to be involved, or not involved, in the transaction.

41. We were shown a copy of what appeared to be a copy of a letter dated 12 January 1998 from Mr Foulser to Mr Hemming. It was unsigned. It made reference to an offer letter from Mr Hemming of 7 January 1998, but we had no copy of such a letter. It says that Mr Foulser is enclosing a signed copy of the offer letter and that the offer is accepted subject to two points: first, that if the offer is lowered Mr Foulser reserves the right to withdraw his acceptance, and secondly that while Mr Kingston would need to visit the premises as part of his due diligence, before that took place Mr Foulser required confirmation that there had been a satisfactory conclusion to negotiations with KEL.

42. Mr Foulser was unable to recall this document, or the offer letter of 7 January 1998 it refers to. Absent any further evidence, documentary or otherwise, we do not consider that this unsigned copy letter amounts to evidence of the acceptance by Mr Foulser of any offer. It is apparent that nothing at this stage could have been binding, and the later drafting of heads of terms, which we shall now discuss, militates against this copy letter being of any material assistance.

43. On 23 January 1998, a James Barton of Arthur Andersen sent a fax containing draft heads of terms for the acquisition of the 60% shareholding in BG Foods. The fax we had was addressed to Mr Shipp, though we can infer from its content that Mr Foulser had already received the draft. The fax was also copied to a Nick Jacobs at Rooks Rider, Mr Foulser's solicitors.

44. The draft heads of terms were headed "subject to contract". Apart from those terms dealing with exclusivity, confidentiality and costs, the terms did not constitute a binding agreement. The nature of the proposed acquisition is expressed as follows:

> "It is the intention that the acquisition of BG will be made via a Newco which will be created for the purpose. This Newco will be funded with a mixture of both equity and debt. The equity will be supplied by funds managed by Kleinwort Benson Development Capital Limited, 3i plc and Nigel Kingston. The provider of the debt has not yet been selected."

45. The price specified is £27 million in loan notes for the 60% shareholding. (No details are given as to the terms of the loan notes.) The offer assumes profit before

tax in the year to 30 April 1998 of not less than £4.5 million *under normal trading conditions*.

46. As to finance, the offer is expressed to be subject to Newco raising equity and debt finance, including board approvals where necessary, on acceptable terms. Arthur Andersen state that they are confident, following initial indications from both equity and debt providers, that funds will be forthcoming subject to due diligence. In relation to due diligence, provision is made for that to take place in two phases, the first of which was to involve Mr Kingston and his advisers visiting the business and having access to relevant personnel and documents.

47. The new exclusivity period was to run until 1 May 1998, the intention being that the transaction would be completed before then.

48. It is evident from these draft heads of terms that (a) Kleinwort Benson had indicated that, subject to due diligence, equity funds would be made available, and (b) 3i had indicated that they wished to be one of the equity providers; this was confirmed by Mr Hemming's evidence. It was also the case, therefore, that 3i were not going to prevent there being a sale of the 40% minority at the same time. The profit assumption was based on what was achievable *under normal trading conditions*. This was to take account of particular problems in 1997 in the production facilities of Devon Desserts Ltd. The aim of Mr Foulser was that losses, or reductions in profit, that had arisen as a result of those exceptional problems would effectively be added back in determining whether the profit assumption had been met. Mr Hemming understood this to mean that the intention was to arrive at a "normalised profit", which would exclude both "super profits" and "super losses" (in Mr Hemming's words, "one-off conditions that cause a downside").

49. In the context of a private company such as BG Foods, the fact that the offer was subject to due diligence was significant. As Mr Hemming explained the position, and we accept, due diligence in such a case is fundamental, as it is only during the due diligence process that full information will be obtained in relation to the target company. The fact that the offerors have arrived at the stage of heads of terms means that they have got to the position, having done financial modelling at a high level, of being willing to spend money on the due diligence phase.

50. On 26 January 1998, there was a meeting at Arthur Andersen. From the note of that meeting prepared by Rooks Rider on 27 January 1998, it is apparent that there was a pre-meeting between Mr Foulser and Mr Whiteson of Rooks Rider at which the tax structure created by Mr and Mrs Foulser was discussed and Rooks Rider went through with Mr Foulser a note they had prepared on the heads of terms. The meeting was later joined by Mr Hemming and Mr Barton of Arthur Andersen, who confirmed at that time that Garretts would be acting for them and Nigel Kingston. The final part of the note of the meeting records that it was said that the purchaser needed to be convinced that Mr Foulser was serious about selling the business, and that "BF gave his word about this".

51. On 27 January 1998, Mr Whiteson sent Mr Foulser a draft of a fax intended to be sent to Mr Barton, which attached a copy of the heads of terms, with some suggested riders. Those riders sought to deal with the following matters:

(a) the fact that the relevant shares were not held by Mr and Mrs Foulser, but by the companies to which they had transferred them, Lazerman Limited and Motion Limited (held by Irish Life);

(b) perceived difficulties in seeking to achieve an agreement with KEL in parallel;

(c) additional consideration instead of payment of a dividend;

(d) issues relating to warranties of profits, net assets or other business variables after exchange of contracts;

(e) equity participation for senior management; and

(f) confidentiality undertaking.

52. On the same day, Mr Whiteson sent Mr Foulser a draft letter to be signed by BG Foods' employees relating to disclosure of information to Arthur Andersen.

53. In fact, due diligence was allowed to commence before heads of terms were signed. That appears from a fax from Mr Whiteson to Garretts (solicitors for the acquirers) dated 17 February 1998, in which he states that due diligence had commenced on the basis of confidentiality undertakings, but that Mr and Mrs Foulser were keen to progress the heads of terms.

54. A meeting took place at BG Foods' offices in Sevenoaks on 25 February 1998 between Rooks Rider and Mr Foulser, along with Guy Humphry-Baker, the finance director of BG Foods. The meeting was to discuss the disclosure exercise. It is apparent from the meeting that Mr Kingston had had at least one meeting with BG Foods' management, and that he had not made a good impression. Indeed, Mr Humphry-Baker and Charles Payne had expressed "no confidence" in Mr Kingston as a managing director. Mr Whiteson's advice is recorded as being that, although it would be necessary to understand the purchasers' intentions with regard to senior management, that was not an issue on which the acquisition should get sidetracked. The meeting went on to consider points raised on a due diligence sheet that Mr Whiteson had earlier sent to Mr Foulser.

55. There was then something of a hiatus until the end of March 1998, when a Matthew Dobson of Garretts circulated a fax dated 30 March 1998 with a further copy of the heads of terms for signature. The fax records that Mr Kingston had signed, and asks that the other parties do so. A structure chart attached to the fax shows Mr Kingston and 3i as the shareholders in the acquisition vehicle, Newco, which is shown acquiring the whole of the share capital of both BG Foods and Harpsign Limited, a company owned as to 60% by Mr and Mrs Foulser and as to 40% by KEL, which held certain intellectual property rights licensed to BG Foods. There is no reference in the structure chart to Kleinwort Benson.

56. Mr Dobson wrote again on 1 April 1998 to say that the heads of terms had been signed by both Mr Kingston and 3i, and chasing for the signatures on the proposed sellers' side.

57. On 8 April 1998 Mr Dobson sent a fax to a Mr Eddie Barnes (whose role was not explained to us) with a copy to, amongst others, Mr Whiteson and Mr Kingston, saying that although there had been a delay in connection with the project, matters were progressing and completion was at that time scheduled for the end of April. The heads of terms remained unsigned on the sellers' side; further amendments were, on 7 April 1998, suggested by Mr Whiteson to Irish Life.

58. On 15 April 1998, Mr Whiteson wrote to Mr Dobson sending him the heads of terms signed both by Irish Life and Mr and Mrs Foulser. When questioned about this in cross-examination, at which time he was shown the signed documents, Mr Foulser accepted that he had signed the document in question. Mr Foulser made the point, however, in his evidence, that the documents were not dated and that this could not have been a formal document without dating and without being signed by all parties. That was not a point on which Mr Myerson made any submission, but because Mr Foulser raised it we consider that we ought to comment briefly. It is evident, from the correspondence, and from common practice of which we can take notice, that it was not intended that there should be a single copy of the heads of terms which would be signed, but that the agreement would be signed in a number of copies. We do not have evidence, however, that the heads of terms did take effect, as there was no dated copy, and no correspondence indicating that the agreement was effective from a certain date. In any event, those terms were still subject to contract.

*Mermaidlogic deal*

59. As we have described, Mr Kingston remained involved in the proposed acquisition of BG Foods through Project Frostie at least until 15 April 1998. It was unclear as to precisely when Mr Kingston's involvement ended. What is clear from Mr Hemming's evidence, which we accept, was that it was 3i that had parted company with Mr Kingston. As we have described, Mr Kingston's position had been taken by Mr Stainow.

60. We had no detailed evidence of the involvement of Kleinwort Benson, apart from the rather cursory references to them in the correspondence and certain of the documents we have referred to. It is evident, however, that Kleinwort Benson withdrew from the proposed transaction some time before Mr Kingston did. The equity participation of Kleinwort Benson had been replaced by that of 3i before the end of March 1998 when the structure chart attached to the 30 March 1998 fax from Mr Dobson showed 3i and, at that time, Mr Kingston as the equity participants in Newco.

61. From the middle of April 1998 the evidence shows that it was 3i that had taken the lead in the due diligence process. A letter to Mr Foulser from Murray Grant of 3i dated 18 June 1998 refers to due diligence having extended over the previous two months. As a result of the analysis undertaken by 3i, certain concerns had arisen over

the new factory planned for construction. Mr Grant's letter proposed a price reduction on account of the risks identified in this respect, to enable a further £4 million cash to be available for the business.

62. A letter from Mr Foulser to Mr Grant dated 14 July 1998 refers to the price re-negotiation and expresses frustration at the failure of Mr Grant to make clear in writing that 3i were satisfied that their concerns regarding "risk limitation" in the building of the new plant had been addressed and that the matter had been resolved in favour of Mr and Mrs Foulser. Mr Foulser says in this letter that if the parties are not in the position to exchange contracts by mid-August of that year, he intends to withdraw from the negotiation. Mr Foulser refers to due diligence having taken "four months directly with [3i] and several more months with Arthur Andersen". A director of 3i, Ms Sue Hunter, replied on 15 July 1998 to say that a mid-August exchange could be aimed for subject to a number of outstanding issues. There was further correspondence from Ms Hunter on 20 July 1998, when it was confirmed to Mr Foulser that the agreed price for the majority holding was £27 million.

63. Mr Foulser's willingness to contemplate withdrawing from the Frostie transaction with 3i can be confirmed by the fact that he was continuing to entertain an alternative. An attendance note of a telephone conversation between Mr Foulser and Mr Whiteson of Rooks Rider demonstrates that Mr Foulser had been discussing a possible deal with Daniels. The note records:

> "Daniels had continued to pursue BG Foods. Although the higher price made their offer more attractive, Brian wished to proceed with the existing offer so long as it completes within the timetable mapped out…"

64. The way this is expressed begs the question: what was the price offered by Daniels higher than? Mr Gibbon submitted that this could only be in relation to the Frostie offer which was at that time on the table from 3i, namely £27 million for the 60% interest. We find otherwise. Our finding is that this was a reference simply to Daniels having increased its own offer, and bore no relation to the price being discussed with 3i. The unchallenged evidence of Mr Freedman was that Daniels' indicative offer was for the whole of the share capital of BG Foods and had been in the range of £16.42m for a cash deal and £24.5m for a share-for-share deal, assuming aggregate sustainable operating profits of £3.5m, and that Daniels had been outbid by 3i in 1998.

65. We were shown a copy of a draft due diligence report for Project Frostie dated August 1998. This was in two parts: a main part and a separate section on projected trading and cash flows, which draft section was faxed by PwC to Mr Humphry–Baker of BG Foods on 28 August 1998. In that separate section it was recorded that it had been assumed that the construction of the new factory for Devon Desserts Ltd would cost £5 million, which included a contingency of £0.5 million.

66. We were also taken to a copy of the Project Frostie Business Plan, sometimes described as "the Frostie Report". This was a business plan produced by the intended management team, including existing management and Mr Stainow, which was

completed shortly before completion of Mermaidlogic's acquisition in November 1998. The document was produced by Arthur Andersen, but their role was, as Mr Hemming agreed, purely one of presentation of management's plan. The plan was solely that of the management. On the other hand, Arthur Andersen would not have permitted the report to say anything that was clearly incorrect.

67. The report disclosed a number of exceptional items. Chief amongst these were the operational problems between July and October 1997 in the Devon factory. Measured against a maintainable margin of 27%, the loss of margin for the four-month period was calculated at £434,959. It was recorded that, subsequently, controls had been re-imposed, the management structure had been strengthened and there was better sales forecasting and planning.

68. Of those responsible for the production of the Frostie Report, we heard evidence only from Grahame Foulser. His involvement was, however, very limited. His evidence was that he was asked to provide information for the plan concerning machine capacities. He did not have any involvement in, or knowledge of, the input of his information into the sales or business forecast. Nor, from his evidence, did he even have any input into his own biography. Indeed when, after receiving a copy of the draft report, he had wished to discuss with Mr Stainow certain aspects of the forecast which Grahame thought were optimistic, he was firmly told that his responsibilities lay only with production. That was Grahame's evidence, and we accept it.

69. Grahame Foulser was one of those copied in on a draft disclosure letter sent by Garretts to Osborne Clarke on 4 September 1998. He was included as one of the potential signatories of that letter, although his name was at that stage square-bracketed. At that stage it does not appear that Grahame had legal representation, and he could not recall this particular draft in evidence. His only recollection of the disclosure letter was when it had been signed on completion when his own solicitor had been present. We accept that Grahame played no material active role in the process.

70. We find, on the other hand, that Grahame did have an input, albeit a limited one, into the due diligence report prepared by PricewaterhouseCoopers. He told us about a due diligence visit undertaken by PwC to the Devon factory, during which he was interviewed. The visit had lasted about a week, although Grahame's personal discussion with PwC had lasted only a short time, something around half an hour. The due diligence report contained a summary of the operational and logistical problems experienced at Devon Desserts in 1997. It also contained a note of Grahame's appointment as managing director of Devon Desserts in January 1998 and three areas on which he had been focused. Grahame accepted, and we find, that this information had come from him during his interview with PwC.

71. The sale of the 60% interest in BG Foods to Mermaidlogic, by means of the sale of Lazerman and Motion, along with the sale of Harpsign, was completed on 2 November 1998. The consideration for the 60% interest was £27,348,482. On

completion of that transaction, Mermaidlogic became entitled to exercise call options over the shares in KEL on payment of an aggregate option price of £8,560,387.

### Mr and Mrs Foulser's tax planning

72. Evidence was given at the 2005 hearing concerning the steps taken by Mr and Mrs Foulser to mitigate CGT on a sale of BG Foods. The scheme entered into, which was, as we have described, ultimately found to have been unsuccessful, was discussed at a meeting between Mr Foulser and his accountant, Mr Shipp, in the Isle of Man on 7 November 1997.

73. In his decision released on 22 February 2005, Dr Avery Jones made the following findings in that respect:

> "Mr Foulser on the introduction of his investment adviser Mr Ceryl Johns, and accompanied by his accountant Mr Donald Shipp, visited Mr Gittins, the shareholder and managing director of Mt Management Ltd, in the Isle of Man on 7 November 1997. Mr Gittins' note of the meeting records that the Foulsers had 60% of the shares in BG Foods, and that following an approach by Arthur Andersen a formal offer of £26m for their shares had been tabled. Mr Foulser completed a form for Mr Gittins stating that his tax planning objective was to mitigate capital gains tax on the sale of the company. There were suggestions by Mr Foulser and Mr Shipp in evidence that the initial object of the visit was planning for the future of the business after Mr Foulser's death bearing in mind that one of his children worked in the business and two did not. I find from Mr Gittins' note that the visit was solely to discuss mitigation of capital gains tax following the offer."

74. Mr Gibbon argued that these factual findings are the starting point for this Tribunal, that given the passage of time any departure from those factual findings should only be on the basis of the most persuasive material, and that such material should not include oral testimony unsupported by documents.

75. Whilst acknowledging the constraints which necessarily follow from a finding of fact made earlier in the same proceedings, and the critical approach to unsupported witness testimony that we should in those circumstances properly adopt, we do think it is right that we should reach our own conclusions on this matter. We have regard to the fact that, although an affidavit of Mr Johns was admitted into evidence in the 2005 proceedings, the special commissioner did not have the opportunity, as we have done, of hearing oral evidence from Mr Johns.

76. Mr Johns described his business as being primarily concerned with pensions and investment advice. It was in that capacity that he advised Mr and Mrs Foulser. One concern of Mr Foulser, according to Mr Johns, was how their estate planning could be arranged so as to treat all of their three children equally, having regard to the fact that only one, Grahame, worked in the BG Foods' business.

77. Mr Johns' evidence was that it was this estate planning that was the subject of discussions between him and Mr Foulser in mid-1997, as a result of which Mr Johns

arranged for advice to be obtained from a former colleague of his at Allied Dunbar, one Mr Andy Lee, who at that time was working for Manx Trust in the Isle of Man. A meeting was held at the Institute of Directors in London at which trusts and inheritance tax was discussed. We find that that meeting took place in October 1997. Mr Lee suggested at that meeting that advice be sought from Mr Gittins of Mt Management Ltd. At some stage, whether at the London meeting or later, but before the meeting with Mr Gittins took place, Mr Johns became aware that Mr Gittins would also be able to advise on CGT planning.

78. It is thus clear, and we so find, that the meeting with Mr Gittins was for the purpose of discussing CGT planning. But we do not consider that it would be right for us to conclude, on the evidence we have heard and considered, that CGT planning was the *sole* reason for the visit to the Isle of Man. We differ, therefore, from the conclusion reached by Dr Avery Jones in this respect.

79. In his published decision, Dr Avery Jones rejected the suggestion made by Mr Foulser and Mr Shipp in their evidence in 2005 that planning for the future of the business was the initial object of the visit. In doing so, the special commissioner relied upon a note of the meeting produced in evidence by Mr Gittins. That note records points arising at the meeting in the Isle of Man on 7 November 1997. It recites the October 1997 indicative offer from Arthur Andersen, notes that Mr Foulser had said that he would not rule out a move to Jersey, although he did have family in the UK, and refers to a *Furniss v Dawson* "health warning". That note was supplemented by an "offshore tax planning questionnaire" completed by Mr Foulser, in which he refers to his tax planning objectives (specifically, in relation to the information contained in the questionnaire) as being "to mitigate CGT on sale of private company". Mr Gittins followed up with a letter to Mr Foulser on 12 November 1997, in which he described the offshore bond scheme that Mr and Mrs Foulser subsequently entered into.

80. There is no doubt that the meeting of 7 November 1997 was intended to include discussion of CGT planning. There is also no doubt that the meeting came to be dominated by the CGT discussion. That was, from Mr Gittins' note, clearly the primary focus of Mr Gittins himself. It was also an approach which was met with interest by Mr Foulser, having regard to a possible future sale of BG Foods. It would have been surprising if, having had a number of approaches regarding a possible sale of the company, including most recently that of Arthur Andersen, Mr Foulser had not taken the opportunity of considering the structuring Mr Gittins was putting forward. But our finding is that it was Mr Gittins who placed this issue at the forefront of the discussions, and not Mr Foulser or Mr Shipp or Mr Johns. The purpose of the meeting in the Isle of Man, so far as Mr and Mrs Foulser were concerned, was not solely to discuss mitigation of CGT following the indicative offer even though, in the event, it was CGT that formed the prime focus.

81. On 14 March 1998, each of Mr and Mrs Foulser made claims for hold-over relief under s 165 TCGA in respect of their gifts of shares to Lazerman and Motion, and requested valuations to be deferred. Mr Foulser included an estimate of the value of his shareholding at £21,250,000, and Mrs Foulser estimated the value of her

shareholding at £3,750,000. We accept that these estimates were not based on any valuation process. They appear to have been based on an assumed value for a 60% holding in BG Foods of £25 million, split on a pro rata basis between Mr Foulser's 51% interest and Mrs Foulser's 9% interest.

5 **The law**

82. Those are our findings of primary fact. Much of the argument on the facts concerned the inferences to be drawn from the primary facts. It is those inferences that bear upon the conclusions reached by each of the experts. We shall therefore consider the expert evidence on valuation before considering what inferences may be drawn, and how those inferences might affect the valuation exercise. Before doing so, we shall summarise the law which is to be applied in undertaking that exercise.

83. The disposals of shares in BG Foods by Mr and Mrs Foulser were by way of gift. Accordingly, s 17 TCGA treats those disposals as having been for a consideration equal to the market value of the respective shareholdings. In Mr Foulser's case the relevant holding is a majority holding of 51%; Mrs Foulser's holding is a minority holding of 9%. The value of each of these holdings has to be considered separately.

84. Sections 272 and 273 TCGA concern valuation for CGT purposes. So far as relevant to shares in private companies, s 272 provides:

> (1) In this Act "market value" in relation to any assets means the price which those assets might reasonably be expected to fetch on a sale in the open market.
>
> (2) In estimating the market value of any assets no reduction shall be made in the estimate on account of the estimate being made on the assumption that the whole of the assets is to be placed on the market at one and the same time…

85. Section 273 contains further provisions relating to unquoted shares. It provides:

> (1) The provisions of subsection (3) below shall have effect in any case where, in relation to an asset to which this section applies, there falls to be determined by virtue of section 272(1) the price which the asset might reasonably be expected to fetch on a sale in the open market.
>
> (2) The assets to which this section applies are shares and securities which are not [quoted] on a recognised stock exchange at the time as at which their market value for the purposes of tax on chargeable gains falls to be determined.
>
> (3) For the purposes of a determination falling within subsection (1) above, it shall be assumed that, in the open market which is postulated for the purposes of that determination, there is available to any prospective purchaser of the asset in question all the information which a prudent prospective purchaser of the asset might reasonably require if

> he were proposing to purchase it from a willing vendor by private treaty and at arm's length.

86. These are the versions of s 272 and s 273 that applied at the relevant date of 24 November 1997. The only change that has been made since then was to replace the word “quoted” in s 273(2) with the word “listed” (FA 2007, s 109, with effect from 19 July 2007).

87. What is postulated is a sale in the open market. The sale is hypothetical, as is the identity of the seller and the purchaser (*IRC v Clay* [1914] 3 KB 466, at p 473). The seller is a willing seller, that is one who is prepared to sell, provided a fair price is paid under all the circumstances of the case. It does not mean only a seller who is prepared to sell at any price and on any terms and who is actually at the time wishing to sell (*IRC v Clay*, per Pickford LJ at p 478).

88. Although the sale is hypothetical, the open market is not. Thus it must be assumed that the whole world is free to bid, and this will include a person or persons who might have a particular reason for paying a higher price than others. The effect of a “special purchaser” of this nature is to be taken into account, along with the possibility that such a purchaser might not actually purchase the relevant property. As Hoffmann LJ described it in the capital transfer case of *IRC v Gray* [1994] STC 360 at p 372:

> “The valuation is thus a retrospective exercise in probabilities, wholly derived from the real world but rarely committed to the proposition that a sale to a particular purchaser would definitely have happened.”

89. As Hoffmann LJ went on to say, the concepts of a willing seller and a willing purchaser do not mean that, having calculated the hypothetical value, one then asks whether the hypothetical parties would have been pleased or disappointed with the result, for example by reference to what the property might have been worth at a different time or in different circumstances. Considerations of that nature are irrelevant.

90. Because the question concerns the price which is assumed to be achieved on a given date, it must also be assumed that there has been relevant marketing and exposure to the market beforehand (*Duke of Buccleuch v IRC* [1967] 506, per Lord Reid at p 525, and see also per Lord Reid in *Lynall v IRC* [1972] AC 680 at p 695).

91. The purchaser is assumed to be prudent, which entails an assumption that the purchaser will have informed himself with regard to all relevant facts, such as the history of the business, its present position, its future prospects and the general conditions of the industry. The purchaser is assumed to have had access to the accounts of the business for a number of years (*Findlay’s Trustees v IRC* (1938) ATC 437, per Lord Fleming at p 440). The range of information available to a prudent purchaser was expanded in 1973 by the inclusion of what is now s 273(3). Such information is assumed to have been obtained by the hypothetical purchaser if a prudent purchaser might reasonably require it if he were proposing to acquire the relevant shares or securities from a willing seller by private treaty and at arm’s length. This formulation enables confidential information, which might not otherwise be

volunteered in a particular case, but which may reasonably be required, to be assumed to have been obtained.

### The experts' valuations

92. Experts instructed by each of the parties produced reports, and gave oral evidence before us. The experts were:

(1) For Mr and Mrs Foulser, Mr Brian Spence, a Fellow of the Institute of Chartered Accountants in England and Wales and a member of the Academy of Experts. At the time of preparing his reports in April and May 2010, Mr Spence was also a director of Montpelier Professional (Manchester) Limited, Chartered Accountants, which was associated with Mr Gittins' company. His experience includes the preparation of share valuations for matrimonial, commercial and fiscal disputes.

(2) For HMRC, Mr Christopher Glover, who is now semi-retired, but who has for many years been one of the leading specialists in share valuation. He has been the author of five editions of a practitioners' textbook, *Valuation of Unquoted Companies*, to which reference was made in these proceedings.

93. The reports of the two experts display fundamental differences in methodology and approach to the valuation, and consequently a marked difference in the valuations arrived at. Mr Spence values Mr Foulser's 51% shareholding in BG Foods at £6,000,000, and Mrs Foulser's 9% holding at £243,750. Mr Glover's valuation of Mr Foulser's holding is £20,638,000, and that of Mrs Foulser £2,500,000.

94. It will be apparent that there was very little about which the experts could agree. Apart from purely factual matters such as the assets to be valued and the date at which the valuation was to be made, the only material areas of agreement were as follows:

(a) The basic nature of BG Foods activity was agreed as being the provision to major multiple retailers of own-label chilled dairy desserts and chilled and frozen puddings;

(b) As regards the valuation of Mr Foulser's 51% shareholding, this should be done by first assessing the value of BG Foods in its entirety. To the pro rata (i.e. 51%) entirety value thus calculated there should be applied a discount to reflect the fact that 51% control is inferior to 100% control; and

(c) The entirety value referred to in (b) should be arrived at by applying a suitable multiplier (price earnings (P/E) ratio) to BG Foods' earnings.

95. We turn now to describe the opposing approaches adopted by Mr Spence and Mr Glover. We shall do so by reference to the areas of disagreement identified by the experts themselves.

**Mr Spence's approach**

**A. Mr Foulser's 51% shareholding**

*Earnings*

96. In Mr Spence's opinion, the earnings component of the calculation should be on the basis of "future maintainable earnings". Mr Spence describes this in terms of it being common share valuation practice to adjust the reported pre-tax profits for items that are unlikely to recur under new management in order to arrive at what he describes as the core underlying profits of the trade.

97. Mr Spence's starting point is not, however, the historic reported pre-tax profits which appeared in the statutory accounts of BG Foods. Mr Spence takes the view that a prudent purchaser would have been concerned by a number of factors, identified by him as:

(a) production problems at Devon Desserts;

(b) the substantial capital investment that was required in terms of production capacity;

(c) the effect of foreign exchange profits on profits; and

(d) the depreciatory effect of capital investment and a larger working capital requirement on future earnings.

98. As a result, Mr Spence considers that a prudent purchaser would have asked for the latest management accounts, which covered the period of 22 weeks from 1 May 1997 to 30 September 1997 (a period of 5 months), which showed actual profits before tax of £1.503 million and anticipated profits before tax for the remaining part of the year budgeted at £3.967 million. Mr Spence then reasons that the budgeted figures would have become meaningless having regard to actual performance to 30 September 1997, and would consequently have been heavily discounted by a purchaser. In fact Mr Spence ignores the budgeted figures altogether, and calculates the base pre-tax profits for the year to 30 April 1998 by annualising the actual five-month profits of £1.503 million to arrive at a figure for the year of £3.607 million.

99. Mr Spence then makes a number of adjustments to the annualised figure of £3.607 million. First, he adds back an amount of £250,000 in respect of what he describes as an increase in Devon Desserts' efficiency. This is an estimate of the non-recurring cost of the production difficulties experienced in Devon Desserts in the five-month period to 30 September 1997. Next, he makes deductions for certain items in order to arrive at what, for Mr Spence, is the core trading profit:

(a) "foreign exchange profits" estimated at £1 million;

(b) a reduction in interest receivable of £117,000 based on the fact that funds earning interest would be used as a deposit on the new factory and such interest was a source of income that could disappear through the vagaries of working capital management; and

(c) an increase in interest payable of £409,000, calculated by Mr Spence on the basis of interest on borrowings of £4.2 million at an annual interest rate of 9.75%, which Mr Spence believes would have been applied to borrowings secured on the new factory. The figure of £4.2 million is estimated on the assumption that a bank would have lent up to 70% of the capital costs of the factory (£6 million according to the Frostie Report).

100. Royalties of £10,000 paid by BG Foods to Harpsign Limited, a company under common control which owned certain intellectual property, were added back to increase the future maintainable earnings. Mr Spence also considered whether any adjustment should be made in respect of directors' emoluments, but concluded that the difference between actual emoluments and figures derived from external sources was immaterial and that no adjustment was required.

101. Finally, Mr Spence deducts tax at 31%, and arrives at a figure for post-tax future maintainable earnings of £1.615 million.

*Foreign exchange profits*

102. In his report, Mr Spence explains the background to the £1 million adjustment in respect of foreign exchange profits in the following terms:

(a) At the beginning of each accounting year an exchange rate for the French franc would be set – the "Standard Exchange Rate". Say, for the sake of this example, that it was set at 8FrF to £1.

(b) When an invoice from a French supplier was received for, say, FrF8,000, the invoice was converted into Sterling using the Standard Rate, arriving at a Sterling value of £1,000 which was accounted for by debiting Purchases with £1,000 and crediting the liability to the supplier with £1,000.

(c) When the invoice came to be settled – usually no more than 6 weeks from its receipt – the exchange rate could have moved to, say, FrF10 to £1, resulting in a sterling costs of £800. The payment of £800 would be debited to the supplier's liability account and credited to bank payments.

(d) This would have left an exchange profit of £200 sitting on the supplier's liability account, which would then be cleared by transferring the £200 exchange profit out of the supplier's liability account to the credit of purchases, thereby reducing the cost of goods sold and increasing profits by £200.

103. Exchange profits (and losses) of that nature are considered by Mr Spence to be outside the scope of what should be regarded as core profits or future maintainable earnings. To arrive at a figure of profit which should be deducted from the annualised management accounts pre-tax profit, Mr Spence adopts the figure of £661,287 for the year to 30 April 1998 described by Mr Humphry-Baker in a memorandum to Mr Foulser dated 6 August 1997 as a "positive currency variance against budget". He then considers that the figure of £661,287 was based on a difference between the

Standard Rate of FrF 8.85 and an assumed average exchange rate of FrF 9.282 to £1, whereas in fact the actual average for 1997/98 was FrF 9.855 to £1. This, Mr Spence reasons, means that the company's estimate of foreign currency gains was understated, and this Mr Spence says is supported by the management accounts to 31 March 1999, which disclose currency gains for the 11 months to 31 March 1998 of £850,000. Mr Spence then makes certain assumptions as to unpaid invoices at the year end, compares the year end exchange rate with the Standard Rate and estimates the full year currency gains at £1 million. That is the figure which is deducted from the annualised pre-tax profit.

*Capitalisation factor*

104. To the figure of future maintainable earnings of £1.615 million arrived at by Mr Spence, he applies a capitalisation factor of between 8 and 10 to give a range of values for the entire company of between £12.92 million and £16.15 million.

105. Mr Spence eschews the method of applying a P/E ratio of a comparable quoted company, or an industry sector average shown in the FT actuaries indices published by the Financial Times, to earnings and then applying a discount to reflect the unquoted status of the company in question.

106. Mr Spence makes the point that there was no immediate prospect of a public flotation of the shares of BG Foods, and points to the following reasons why, in his view, a quoted P/E ratio would not be appropriate:

(a) It is virtually impossible to find a listed company that is comparable in terms of size, product range, market penetration and management with the relevant private company.

(b) P/E ratios are calculated as the *result* (Mr Spence's emphasis) of a company's reported earnings and the market's expectations of the company's prospects. P/E ratios should not be used as the *determinant* of value.

(c) P/E ratios are derived from the sale of small bundles of shares. The shares in BG Foods represent a controlling shareholding and a minority holding.

(d) Purchasers of quoted company shares generally have no desire to be involved in the management of the business.

107. Instead, Mr Spence derives his capitalisation factors from the Private Company Price Index ("PCPI") complied quarterly by BDO Stoy Hayward. Mr Spence explains in his report that the PCPI is compiled from data applicable to medium to large private companies, and that by virtue of that fact it is to be preferred to the use of a quoted P/E ratio. He goes on to say that the PCPI is popular with private company valuers, that it is produced in conjunction with the periodical *Acquisitions Monthly* and that it plots the P/E ratios of the Financial Times' non-financial sector on a quarterly basis over six-year periods against the P/E ratios achieved on actual private company sales.

108. For the fourth quarter of 1997, Mr Spence explains, on average private companies were being sold for 10.4 times their historic profits after tax. They were being sold at a discount of 48% of their quoted counterparts' P/E ratios (19.9 for quoted companies; 10.4 for unquoted companies).

5 109. Mr Spence then considers a number of further factors before arriving at his judgment of what he describes as a realistic capitalisation factor of between 8 and 10:

(a) Mr Spence takes into account the views of the "industry witnesses" we described earlier, as contained in the witness statements of those witnesses. Those industry witnesses, Mr Spence explains, would have
10 applied multipliers in the range of 6 to 10, although those multipliers would have been applied to a variety of profit calculations, ranging from EBITDA, and profits both before and after tax. The entirety values arrived at for BG Foods, assuming a cash purchase were between £10.5 million and £16.42 million (average £13.62 million), although one
15 witness, Mr Freedman, would have placed a value of £24.5 million if the price could have been settled in the shares of the purchaser. (Mr Spence discounts this as being "an offer which I doubt would have found favour with Mr Foulser".)

(b) Mr Spence also considers a number of enquiries in relation to the
20 possible acquisition of BG Foods, dating from October 1994 up to the date of the indicative offer from Arthur Andersen of 29 October 1997. He discounts the latter as being in his view "a seller's price, not a valuation of what a prospective purchaser might offer".

(c) He takes into account the acquisition by KEL of the 40% minority
25 interest in two tranches on 25 January 1996 and 29 April 1996 for a total consideration of £3,659,500, and the proposal (which did not mature into a transaction) to acquire Mr and Mrs Foulser's 60% shareholding for £12 million. Mr Spence calculates that this proposal represented a pre-tax multiplier of 6.96 for the entirety value of BG Foods, and 8.9 for the 60%
30 shareholding, based on target profits of £2.25 million, and on this basis the value based on the pre-tax profits in the 1996 accounts (which were lower than the target figures) would have been £14,280,760.

(d) Mr Spence takes the view that no account should be taken of the sale of BG Foods to Mermaidlogic in November 1998. His view is based,
35 he says, "not just because it was a sale by private treaty, rather than being based on a fiscal valuation basis" but because he regards 3i as a special purchaser. Having regard to the investment of 3i in BG Foods prior to the Mermaidlogic deal, Mr Spence calculates that 3i increased its investment in BG Foods by an additional 74.77% at a net cost of £12.15 million. He
40 dismisses the financial forecasts on which the Mermaidlogic deal was based as being unrealistic and concludes that the deal was "fatally flawed in its assumptions".

110. Having arrived at future maintainable earnings of £1,615,000 and a capitalisation factor of between 8 and 10, Mr Spence's entirety value for BG Foods is

between £12,920,000 and £16,150,000. To those figures, in calculating the value of Mr Foulser's 51% shareholding, he applies a discount to take account of the fact that Mr Foulser did not have total control. Mr Spence refers, in this respect, to a textbook, *Practical Share Valuation*, Eastaway, Booth and Earner, Butterworths, 3rd edition at §17.12 where it is stated that in the case of a trading company a 50.1% holding would command a discount of at least 20% to 25% in normal circumstances. On this basis, Mr Spence considers that a discount of 20% is appropriate.

111. The result is that Mr Spence values Mr Foulser's 51% shareholding in the range of £5,271,360 and £6,589,200, and selects a value of £6 million.

**B. Mrs Foulser's 9% shareholding**

112. Although at the material time BG Foods was not paying a dividend, Mr Spence considers that it would not be appropriate to value the minority holding of 9% on a discounted entirety value derived from an application of the earnings basis. He reasons that a purchaser, having been informed of the fact that, although dividends had been paid in the past they were not at that time being paid because of a disagreement between the majority and minority shareholders, would not have been prepared to pay a significant sum for a 9% holding.

113. Mr Spence therefore reasons that a rational investor would have required a yield of between 2 and 4 times the relatively risk-free rate of return that could be achieved from a high interest-bearing deposit account, which Mr Spence puts at 6% in 1997. At 4 times, the rate is 24%. That yield is applied to an assumed dividend return on a 9% holding of £58,500, derived from the dividends declared in relation to the year ended 30 April 1996, giving a value for the 9% holding of £243,750.

**Mr Glover's approach**

**A. Mr Foulser's 51% shareholding**

*Earnings*

114. Mr Glover's starting point for the application of the earnings basis for ascertaining the entirety value of BG Foods is simply the unvarnished after-tax profit disclosed in the audited accounts of the company for the year ended 30 April 1997, the latest accounts prior to the valuation date.

*Valuation multiple*

115. Mr Glover takes the view that, as a supplier of chilled dairy products to UK supermarkets, BG Foods would, if it had been quoted, probably have been regarded as a food producer. The relevant FTSE actuaries' industry sector is therefore, in Mr Glover's opinion No 33, Food Producers, which included 65 companies.

116. Mr Glover then seeks to compare the performance of BG Foods with that of companies in the Food Producers index. Because of the size and different type of

activity only a few of the 25 companies in that index were directly comparable with BG Foods. Mr Glover selected six companies from the sector (two of which were from the index) for comparison. This was an essentially random selection which was intended by Mr Glover to be a proxy for the sector as a whole. The six chosen companies were:

Northern Foods
Dairy Crest
Cavaghan & Gray
Daniels
Perkins Foods
WT Foods

117. In terms of turnover growth, the comparison revealed a mixed picture. For the most recent years, BG Foods' growth rate in turnover was well above that of all the companies, except Cavaghan & Gray. In earlier periods, however, BG Foods' growth rate was well below average.

118. As regards pre-tax profit margin, in the most recent year that of BG Foods exceeded that of other companies. In the earlier years it was consistently high and well above average. BG Foods' earnings growth rate over the period as a whole was well above average and superior to the quoted comparables. A comparison of normal earnings per share (as opposed to FRS3 earnings per share) shows that in the most recent year BG Foods' earnings growth rate was overshadowed by that of Cavaghan & Gray and Perkins foods, but in each of those cases there had been a fall in earnings in the previous year. Overall, therefore, Mr Glover concludes that BG Foods' earnings growth over the period as a whole was far superior to that of the other companies.

119. Whist he acknowledges that the comparisons made are broadbrush and approximate, Mr Glover's view is that they support the conclusion that BG Foods' trading performance and prospects would have been seen as above average, and that, if listed, BG Foods would have commanded an above-average rating as far as trading performance and prospects were concerned.

120. On the other hand, Mr Glover recognises that allowance has to be made for the risk inherent in the company, including its size, its reliance on two supermarkets for more than 50% of its turnover and its vulnerability to exchange rate movements on account of half its sales being sourced from Continental suppliers. Applying his experience, and subjective judgment, Mr Glover arrives at an "as quoted" P/E ratio of 15, which, he says, is approximately equivalent to the Food Producers sub-sector P/E ratio of 19.67 discounted by 25%.

121. Mr Glover then notes that stock exchange P/E ratios are applicable to small parcels of shares, and that the bid price for an entire company would include a bid premium to the ruling price per share. By reference to certain empirical data, including data derived from *Acquisitions Monthly*, Mr Glover takes the view that a bid or control premium would tend to be between 30% and 50% of the pre-bid share

price. In this respect his report notes that the November 1997 edition of *Acquisitions Monthly* reported an average bid premium of 35% in the third quarter of 1997, following 29% in the second quarter and 42% in the first quarter. The average bid premium for 1996 was 31% and for 1995 36%.

122. Mr Glover selects a bid premium of 40% as being the mid-point between 30% and 50%, thus arriving at a control P/E ratio of 21. Applying that ratio to the historic earnings of £1,927,000 produces an entirety value for BG Foods of £40,467,000. Mr Glover recognises that this takes no account of any severance costs which might have been incurred in relation to Harpsign (which owned certain intellectual property used by BG Foods) but concludes that this is not material.

123. An historic P/E ratio of 21 translates, according to Mr Glover, into a prospective P/E ratio of 15 on the basis of projected earnings for 1997/98 of £2,698,000. That figure is calculated by Mr Glover by taking the percentage increase in turnover between the six-month periods ended 31 October 1996 and 1997, which is calculated at 40%, assuming that rate of growth continues for the second half of 1997/98, and applying that rate to both pre- and post- tax profits. The result is a projected post-tax earnings for 1997/98 of £2,698,000 (£1,927,000 plus 40%). The prospective P/E ratio of 15 is then compared with bids for UK food companies, both quoted and private, which were recorded in the July to December 1997 editions of *Acquisitions Monthly*. The prospective P/E ratios ranged between 11.8 (Howard Long – private) and 39.4 (Borthwicks – listed). Of the other private bids recorded, Sun-Ripe had a prospective P/E ratio of 15.7 and Beni Foods a prospective P/E ratio of 16. Mr Glover concludes that a prospective P/E ratio of 15 for BG Foods appears reasonable by comparison.

124. Mr Glover then notes that Cavaghan & Gray, one of the quoted food producers selected for comparison, was itself acquired by Northern Foods in February 1998, shortly after the valuation date. Mr Glover takes the view that Cavaghan & Gray was the quoted company most like BG Foods in terms of activity and size, and that Northern Foods' bid is therefore likely to be indicative of conditions at the valuation date. The data derived from *Acquisitions Monthly* shows an historic P/E ratio of 21.8, but this excluded the cost of the subsequent acquisition of shares issued on exercise of share options. Taking that into account, the true historic P/E ratio was 22.2. Mr Glover notes that BG Foods has a higher net assets multiple, but considers that this is less significant than future profits. He concludes that the Cavaghan & gray acquisition price lends strong support to an entirety value of BG foods of £40,467,000.

125. To that entirety value, Mr Glover applies a discount to reflect the fact that a 51% shareholding commands a bare majority of the votes and falls short of complete control, including control through the passing of special resolution. Mr Glover's view is that where the company is mature and its trading performance average or pedestrian the inability to pass a special resolution may have little practical significance; in such a case a discount of 10% would be appropriate. However, for an expanding company in a phase of strong growth, Mr Glover says that a lack of full control "can be irksome" and that there are good arguments for putting the discount somewhat higher. He adopts a discount of 15%.

126. On this basis, taking a pro rata percentage of the entirety value and discounting at 15% for lack of full control, Mr Glover values Mr Foulser's 51% shareholding at £17,542,000. However, this does not take account of the effect, if any, of the indicative offer made by Arthur Andersen in October 1997. Mr Glover's view on that is summarised below, after we have set out his opinion on the value of Mrs Foulser's shareholding (again without reference to the October 1997 offer).

**B. Mrs Foulser's 9% shareholding**

127. Although in Mr Glover's view a minority interest of 9%, representing as it does a significant, though uninfluential, minority holding, would normally attract a discount of around 50% of the pro rata entirety value, in the case of BG Foods, a relatively young business in a phase of strong expansion, which had been subject to a number of bid approaches where shareholders would expect to receive the same undiscounted price, Mr Glover considers that a lower discount of 40% would be appropriate.

128. On that basis, taking the pro rata percentage of the entirety value of £40,467,000 and discounting by 40%, Mr Glover arrives at a valuation of Mrs Foulser's shareholding, before taking account of any effect of the October 1997 offer, of £2,185,000.

129. Mr Glover notes that this value is greater than the value that would be derived by extrapolation from the price per share paid by KEL for the 40% minority shareholding in early 1996. The equivalent value for a minority holding of 9% would have been £823,000. However, Mr Glover concludes that those 1996 transactions were irrelevant to the value at the valuation date in November 1997.

**Effect of October 1997 offer**

130. Having arrived at base valuations for each of Mr and Mrs Foulser's shareholdings, Mr Glover moves to consider the effect on those valuations of the indicative offer of £26 million made in October 1997 for Mr and Mrs Foulser's combined 60% shareholding. He assumes that in both cases a prudent purchaser would have been informed of the existence of that indicative offer. Furthermore, Mr Glover assumes that prospective purchasers would have "realised that it was being seriously considered and stood a good chance of acceptance". Mr Glover himself takes the view that the offer "would have been viewed as likely to succeed".

131. Mr Glover then compares the value arrived at independently of the indicative offer with the sums Mr and Mrs Foulser (and, we infer, a holder of their respective shareholdings) could have expected to receive if a sale was completed in accordance with the terms of the offer. Mr Glover summarises the position as follows:

| | **Notional market value £000** | **Offer of £26m £000** |
|---|---|---|
| 51% shareholding | 17,542 | 22,100 |
| 9% shareholding | 2,185 | 3,900 |
| | 19,727 | 26,000 |

132. The result of this comparison, Mr Glover says, is that the price Mr Foulser stood to receive was at a premium of 26% to the notional market value of his 51% shareholding. In the case of Mrs Foulser's 9% shareholding, the premium was 78%. Mr Glover then considers whether and to what extent those premiums should be reflected in the open market value of the two holdings.

133. Mr Glover recognises that the offer might not have progressed to completion. That, he concedes is a matter of subjective judgment. He concludes that Mr Kingston was a credible and creditworthy offeror and expresses the view that the offer was seen as both serious and attractive. Having regard to the fact that offers might fail, Mr Glover expresses the view that a prospective purchaser of the 51% shareholding "would have been prepared to pay at least the full *pro rata* of his shareholding ignoring the offer". That would therefore eliminate the 15% discount for lack of full control and lead to a value for the 51% shareholding of £20,638,000.

134. In relation to the 9% shareholding, on the same basis Mr Glover takes the view that its value must lie somewhere between the basic minority value of £2,185,000 (that is, discounted by 40% from the pro rata entirety value) and £3,900,000 assuming that the holder of the 9% shareholding would receive the same price per share as a controlling shareholder. In Mr Glover's view the lack of certainty over the price would have weighed heavily in the mind of the prospective purchaser of the 9% holding. His subjective judgment leads him to conclude in this respect that a market value of £2,500,000 would fairly reflect the uncertainties. That represents a premium of just under 15% over the basic minority value and a discount of 36% to the full offer price of £3,900,000.

**Discussion**

135. Share valuation is not a science. There is no prescribed formula by which shares in a private company are to be valued. The legislation prescribes an open market, it postulates a hypothetical seller and purchaser and provides for assumptions as to the information a prudent purchaser would have available. A willing seller and a willing, but prudent, purchaser must be assumed. But beyond that, and the principles

developed by the case law we have outlined, the question rests on the experience and judgment of expert share valuers, and in case of dispute the Tribunal.

136. Share valuers may therefore disagree. Often such disagreement is on the detailed application of accepted methods of valuation. Sometimes, however, the experts will disagree fundamentally on the appropriate methodology itself. This case falls into that category. Not only have Mr Spence and Mr Glover adopted different approaches, those approaches have led to vastly different conclusions as to value. It is not a question therefore of seeking only to examine the detail of each evaluation to make a determination. The difference between the valuations must mean that one of the methodologies adopted is fundamentally flawed and must be ruled out.

137. In these circumstances it is not surprising that each side made trenchant criticisms of the analysis of the other's expert. Each of the experts was subject to extensive, but fair, cross-examination. We start by examining the criticisms of the two methodologies. We shall then conclude which of those methodologies we consider represents the better approach. Finally, we shall examine certain detailed aspects of the application of that preferred methodology in order to arrive at our determination of the open market value of the two holdings of shares.

**Examination of Mr Spence's methodology**

**A. Valuation of Mr Foulser's 51% shareholding**

*Earnings*

138. Mr Gibbon submitted that the method adopted by Mr Spence of calculating the profits of the full year 1997/98 by annualising the pre-tax profit for the five-month period to 30 September 1997 was flawed in that it did not take into account management forecasts of profit for that year of £4.5 million, which had been reached after adding back the loss attributable to the production difficulties at Devon Desserts.

139. On its own, we do not consider that this criticism casts doubt on Mr Spence's use of actual results for the five-month period to estimate the outturn for the rest of the year. That may well be something that a prudent purchaser might do, as an alternative to relying on a forecast by existing management. However, we do regard Mr Spence's calculation as flawed. Whatever view might be taken as to the risks in the future of production difficulties of the nature experienced in Devon Desserts in the relevant period, and accordingly what deduction should be made in that respect, the starting point for the calculation of profits for the second seven months of 1997/98 must be the profits of the first five months adjusted to add back exceptional items, including the losses from the production difficulties.

140. Adopting that approach, which we consider to be the correct one, the sum of £500,000 would be added back to the profits for the five-month period of £1,503,000 to give £2,003,000. Annualising that figure for the full year would produce a normalised profit for the year of £4,807,000 which can be compared with the forecast of £4.5 million, the figure expressly considered by Mr Foulser to be achievable under

"normal trading conditions", so disregarding the effect of the production difficulties. This contrasts therefore with Mr Spence's full year profit estimate of £3,607,000.

141. We also consider that Mr Spence's rationale for making a deduction of £1 million in respect of foreign exchange profits was wrong in principle. Although it would in our view be right, in any calculation of maintainable profits, to exclude exceptional items, which could in certain circumstances include foreign exchange profits, the deduction made by Mr Spence was not in our view justified on this basis.

142. The basis for Mr Spence's deduction for foreign exchange profits is the accounting entries made by BG Foods to eliminate an exchange profit which arises as a consequence of the use by BG Foods, for internal budgeting purposes, of a standard exchange rate, fixed at the beginning of each accounting year. For accounting purposes in BG Foods, the sterling value of a foreign currency invoice is ascertained not by reference to the exchange rate at the date of the invoice, but by reference to this Standard Rate. There is therefore a notional gain or loss built into this sterling value.

143. This is then compared to a sterling value fixed on settlement of the invoice at the actual exchange rate on the date of settlement. The exchange profit (or loss) on the supplier's liability account is thus not an actual exchange profit or loss, but an arithmetical calculation of profit or loss by reference to a notional exchange rate. The elimination of that profit or loss by crediting or debiting purchases and reducing or increasing the cost of goods sold is not, as Mr Spence described it in his report, an increase (or decrease) in profits. It is simply a correction of the cost of sales to reflect the actual cost of the goods by reference to the exchange rate on payment. The notional profit or loss created by the use of the Standard Rate is thus eliminated at this stage.

144. That does not of course mean that the profits do not include an element of foreign exchange profit or loss. To the extent that the exchange rate is different at the date of settlement from what it was at the date of invoice, an exchange profit or loss may arise, subject to any hedging arrangements. But the calculation by reference to the Standard Rate does not reflect this true foreign exchange exposure.

145. As to hedging, what little contemporaneous evidence there was supports the view that the exposure of BG Foods to currency risk was substantially hedged. The memo from Mr Humphry-Baker to Mr Foulser of 6 August 1997 refers to FrF 95.75m of forward contracts maturing in 1997/98, and only FrF 13.25m unhedged. According to the Project Frostie due diligence report of August 1998, forward contracts were used to fix rates for currency purchases, and at that time these covered a significant proportion of planned purchases. At April 1998 forward contracts covered purchases of £10.5m. Although we heard evidence from Mr Foulser concerning the use of options rather than forward contracts, we had no documentary evidence to support that.

146. We do not consider, however, that a prudent purchaser would have formed the view that, leaving aside the hedging arrangements, BG Foods would, as a matter of course, be able to control foreign exchange risks through its dealings with its suppliers

and customers. We accept that the Project Frostie business plan of October 1998 stated that certain currency fluctuations would be protected by increasing sales prices or gaining support from the company's European partners, that having regard to a September 1997 reduction in sales prices to the major retailers on the basis of sharing a currency gain there were grounds to believe that sales prices could be increased and that there was an example of such cooperation in 1995/96. But we do not consider that a prudent purchaser would have discounted the currency risk on that account. On the other hand, a prudent purchaser would not have adopted Mr Spence's approach to foreign exchange risk.

147. It follows, in our view, that the basis on which Mr Spence determined that a deduction of £1 million from forecast profit for 1997/98 in seeking to arrive at future maintainable profits was flawed. We do not accept that, even if such a methodology had been adopted by a prudent purchaser, such an adjustment would have been made. Although foreign currency risk existed in BG Foods, we consider that this was no more than an incident of normal trading, the risk of which would be factored into the valuation as a risk factor, but not by means of a flawed deduction. We accept the view of Mr Glover in this respect that a purchaser's assessment of BG Foods future profits would not exclude the effect of normal exchange rate movements on the cost of goods purchased.

148. We also consider that Mr Spence's deductions based on interest on a notional borrowing of 70% of the cost of a £6 million factory are flawed. Mr Spence's report states that the cost of the new factory (including plant and machinery) had been estimated at £7 million. A fax from Mr Foulser to Mr Hemming dated 16 October 1997 puts the figure at £4 million, and this is supported by responses to a supplemental legal due diligence questionnaire in relation to Project Frostie which had been issued by Garretts on 30 July 1998, in which it is stated that the new factory with required plant and machinery was estimated to cost £4 million. We have not seen from the evidence anything that would support an assumption that this cost would be funded by way of debt, or if so in what proportion. Whilst it is reasonable to take account of the cost of funds, whether financed out of the company's own resources or by debt, a prudent purchaser would have some regard to the future contribution of increased investment to the profits. Mr Spence's analysis takes account only of the estimated interest costs (interest payable and/or forgone), and excludes any future profit from the new factory.

149. These factors lead us to question whether the approach of seeking to estimate maintainable profit, in the sense of core or underlying profits is one that would be adopted by a prudent purchaser. It is a heavily subjective concept which in comparison with the historic accounting profit (adjusted for exceptional items recorded as such for accounting purposes) could lead to a multitude of different values being proposed for different hypothetical purchasers. Furthermore, as Mr Glover noted, the concept of maintainable profit sits uneasily with the application of a capitalisation ratio, such as a P/E ratio or a blend of P/E ratios which are typically based on historic earnings.

*Capitalisation factor*

150. We have set out above the reasons why Mr Spence considered that it was inappropriate to use published quoted company P/E ratios or industry sector averages. However, our view is that the PCPI ratio would not have been used by a willing prudent purchaser.

151. In our view it is unsafe to rely on the PCPI for a valuation of this nature. Our reasons, which reflect our acceptance of Mr Glover's evidence in this regard, are as follows:

(1) There is no transparency of the PCPI. No information is available as to the number of private company acquisitions on which the average P/E ratio is based. Nor is anything known about the companies concerned, including their activity and size. It is thus impossible to take any view on comparability.

(2) An approach based on future maintainable earnings requires as its concomitant a market P/E ratio based on such a calculation of earnings. The PCPI is based on reported (historic) earnings. No adjustment has been made to reflect future maintainable earnings.

152. In support of the capitalisation factor which Mr Spence derived from the PCPI, Mr Spence placed reliance upon the views of the "industry experts" who provided witness statements in these proceedings. We do not consider that any support should be derived from that source. As Mr Glover explained, the use of comparable transactions as a guide to value is properly confined to actual transactions. It does not include opinions of persons who are not themselves expert valuers. Mr Myerson sought to undermine Mr Glover's evidence in this regard by reference to a passage in Mr Glover's book and certain remarks made by Mr Glover in cross-examination. We are satisfied, however, that these criticisms go nowhere. As Mr Glover says in his book, it is for the expert valuer to take a view as to the industry background, and references to the views of others are to be confined to actual purchasers, or as Mr Glover put it "those assumed to be". We shall examine later the extent to which we consider that latter concept can be applied in this case by reference to the October 1997 offer and the Mermaidlogic deal.

*Conclusion on Mr Spence's methodology*

153. We find that there are serious flaws in the methodology adopted by Mr Spence in relation to the valuation of Mr Foulser's 51% shareholding, both as regards the concept of future maintainable earnings and his use of a capitalisation factor derived from the PCPI.

**B. Valuation of Mrs Foulser's 9% shareholding**

154. We do not consider that a prudent purchaser would value a 9% shareholding on a dividend yield basis at a time when there was no prospect of a dividend being paid. We do not accept, therefore, that such a valuation is appropriate.

155. In addition, we consider that a purchaser of such a minority interest would have some regard to the fact that the company had been the subject of a number of bid approaches, including the indicative offer of October 1997, as indicating that there was a prospect of a sale of the entirety at some stage in the future. Even if a dividend yield basis of valuation had been appropriate, we consider that a purchaser would have valued, suitably discounted, the future prospect of a sale as part of a bid for the whole company. Although in those circumstances it could not be guaranteed that a minority shareholder would receive the same price per share as the majority holder, it would not be uncommon for that to be the case.

## Examination of Mr Glover's methodology

### A. Valuation of Mr Foulser's 51% shareholding

156. Mr Myerson submitted that Mr Glover's valuation reports and his evidence were both internally inconsistent and also inconsistent with the views expressed by Mr Glover in his book.

*Use of stock exchange P/E ratio*

157. Mr Myerson argued that Mr Glover's use of the P/E ratio he determined was flatly contradicted by his views in his book. He points to the statement, at para 9.5.3 of the book, "… the author's view is that [the P/E ratio] should be avoided when valuing unquoted shares."

158. It is important, in considering what Mr Glover has said in his book, to have regard to the context. The chapter from which Mr Glover's expressed view has been extracted deals generally with the earnings basis of valuation. It discusses a range of valuation techniques, including the discounted earnings method, which seeks to ascertain the present value of a future earnings stream, and in the context of the valuation of unquoted shares, the pre-tax profits yield method, which Mr Glover prefers and which he explains has the advantage of enabling a comparison to be made with yields and rates of return elsewhere.

159. None of this undermines Mr Glover's use of the P/E ratio method in this case. It is evident that this method is a conventional method for the valuation of unquoted shares, provided that (as Mr Glover has done) suitable adjustments are made to take account of the differences between listed and unlisted companies. As Mr Myerson recognised, Mr Glover also makes clear in his book that his strictures against the use of P/E ratios in valuing unquoted shares do not extend to fiscal valuations where a notional quoted value may be required. Although Mr Myerson submitted that the valuation was not for the purpose of obtaining a notional quoted value, and argued on this basis that Mr Glover's caveat did not apply, we consider that the use of a P/E ratio is justified in these circumstances. The valuation required is a fiscal valuation, and in those circumstances the starting point of using the P/E ratio in order to obtain a notional quoted value, which can then be adjusted, is perfectly acceptable. We see no inconsistency with what Mr Glover has said in his book.

160. Nor is any of this affected by Mr Glover's reference in his report to an "investment/valuation viewpoint" when discussing the respective significance of comparisons between BG Foods and the quoted companies chosen by Mr Glover for comparison on the basis of turnover, profit margins and earnings growth. That reference does not suggest that Mr Glover considered his valuation to be anything other than a fiscal valuation (which, we might add, it unarguably is). As Mr Glover explained in his evidence, the investment approach involves taking a view of future profitability and cashflows to ascertain the investment return that should be required given the general level of interest rates and an equity risk premium, and discounting those future returns to present value. Such a valuation is not, as Mr Glover explained, well-suited to a fiscal valuation, because the variables depend on the particular position of an actual purchaser, and this does not readily translate into the hypothetical purchaser that must be assumed in a fiscal context.

161. There is one further point we should address under this heading. We shall have some more to say about the control premium which Mr Glover applied to convert a minority-based P/E ratio into a control P/E ratio, but at this stage we consider Mr Myerson's submission that Mr Glover had introduced a premium for control rather than applying a discount for lack of control.

162. That is not what Mr Glover did. He first converted the stock exchange P/E ratio, which is based on small holdings of shares, into a control P/E ratio by applying a bid premium. That was a logical step, and one we consider appropriate to the valuation process employed by Mr Glover. Secondly, he applied a discount to the pro rata entirety value thus ascertained in order to reflect the lack of complete control for a 51% shareholding, and a greater discount for the non-controlling 9% shareholding. We shall examine the rates applied, but in principle those were entirely appropriate steps. No premium was applied in valuing the 51% holding.

*Earnings*

163. Mr Myerson submitted that the approach of Mr Glover to an earnings based valuation was also inconsistent with views expressed by Mr Glover in his book, at para 9.3.2.1:

> "It will be obvious from the residual nature of accounting profit that a simple extrapolation of the historical earnings pattern is unlikely to provide a reliable basis for estimating future profits … Anyone who mindlessly extrapolates an historical earnings progression in order to obtain a forecast future earnings potential is not a valuer but a number cruncher."

164. Again, it is important to look at this in context. Mr Glover was not saying that past earnings were irrelevant to a forecast of future earnings. He maintained that past earnings were the principal indicator of future potential, although he acknowledged that academic research in this area underlined the need for a valuer to interpret the earnings record in the light of the general economic and industry background and the circumstances of the case.

165. In any event, Mr Glover's valuation methodology did not depend on ascertaining future profits from past performance, and did not involve the mechanical number crunching he cautioned against in his book. The earnings element of his calculation was the historic accounting profit from the audited accounts of the previous year. The analysis he performed of the earnings growth of BG Foods was not for the purpose of forecasting future performance, but to compare the earnings growth of BG Foods with the sector comparables identified by Mr Glover, and to use that, amongst other comparisons, to reach the conclusion as to the notional quoted P/E ration that would be attached to BG Foods. In making these comparisons, Mr Glover took the results of BG Foods for the four years ended 30 April 1997; that did not include any element of forecast future profits.

166. Mr Myerson submitted that, even in a case where historic profits were used as the relevant measure, an adjustment should be made to exclude the effect of foreign exchange profits (or losses), and that this was not something the Mr Glover had done.

167. The basis for this submission was Mr Glover's evidence given in cross-examination. With respect to Mr Myerson we think he has misunderstood what Mr Glover said in this regard. The exchange was as follows:

> Q. (Mr Myerson): Isn't the question, therefore, "Is that going to be the same for next year?" You start with the proposition -- I know it is a multifarious business but let's just assume that per unit, whatever a unit is, your margin is one penny. That is something a prospective purchaser has to assess: can I get away with a penny? Will a penny make enough money for me? Can I charge more than a penny? These are all commercial considerations day on day.
>
> A. (Mr Glover) Yes.
>
> Q. One of the other questions is: will my margin, as it were, be raised beyond the penny by the foreign exchange rate? And in the year that we are talking about, the answer happened to be yes. You agree, and I am not dissenting from it at all, that from a management perspective, that is quite a useful thing to know. From a purchaser's perspective, isn't the question, in fact, because of the effect of the foreign exchange, the margin was not a penny per unit, it was 1.1 pennies per unit; is that going to be the same next year?
>
> A. Maybe counsel is right, that is how he would look at it but I don't think he would myself, sir. He's looking at the general nature of this business, not particularly interested with what happened as between time 1 and time 2. They have a general problem of management of currency fluctuation, and they know roughly how currencies move up and down in normal times and that is what they are interested in.
>
> If there was some obviously abnormal movement, then I think counsel -- I would agree with counsel, they might look at that and try to isolate it, but if we are talking about the ordinary, general run of managing the exchange rate and hedging, where appropriate, I do not think we will be looking at one datum as to the next.

> Q. And even on a past profits basis, you would exclude the 0.1 penny per unit, a notional 0.1 penny per unit, from your valuation?
>
> A. Yes. I do not think that from looking at the past performance of the company, you are looking at the profits and the sales.
>
> JUDGE BERNER: What was that question, you would exclude it from your valuation?
>
> MR MYERSON: Yes, and Mr Glover said yes, because he is looking at past profits.
>
> A. I am not looking at the unit cost, unit margins or anything, I am looking at the past to see what profits the company has made, what turnover its done, how it has performed in its markets.

168. Mr Myerson submitted that Mr Glover had conceded that this element of profit that was due to exchange rates, and not to the cost of goods received or the price paid for them, would be excluded from the valuation. That does not, however, represent a concession by Mr Glover. That does not mean, as Mr Myerson's submission suggests, that historic profits would be adjusted to eliminate the effect of ordinary foreign exchange movements. Mr Glover's evidence, which was consistent with what he said in his reports, was that such movements would be disregarded in a valuation, unless the movement was obviously abnormal. That is what Mr Glover meant when he agreed it would be excluded; he did not mean that it would be deducted. That follows not only from what he said in the passage we have quoted but also in the context of his helpful explanation just prior to that of why foreign exchange was ordinarily a matter for daily management, and not material to valuation, and why Mr Spence's approach in this regard was flawed.

*Selection of comparators*

169. Mr Myerson submitted that Mr Glover had made a critical error in his choice of sector from which to derive the quoted P/E ratio. Mr Glover categorised BG Foods as a food producer, whereas it was argued for Mr and Mrs Foulser that a more appropriate classification would have been as a wholesaler, and that the sector Retailers, Food (which included food wholesalers) would therefore have been applicable. That would be material because the average P/E ratio for the Retailers, Food sector was 17.03 compared with 19.67 for the Food Producers.

170. We do not consider that Mr Glover's assessment of the nature of BG Foods business can be regarded as fundamentally flawed. There is, we accept, as in every valuation exercise, room for debate on issues of this nature. However, like the prudent purchaser would have done, Mr Glover relied on the documents that had been made available to him. From our own assessment of the evidence, it appears to us that BG Foods operated in some respects as a food producer and in others as a wholesaler. BG Foods particular business model, which involved procuring products in branded form for particular supermarkets is a species of wholesaling, but not perhaps what a prudent purchaser might regard as classical wholesaling. That indeed would reflect Mr Foulser's own view; his evidence was that BG Foods' business

model was different from that of a simple wholesaler. What is certain, on the other hand, is that BG Foods was not a retailer.

171. In support of his argument that BG Foods was not a food producer, and in light of Mr Glover's reliance in his report on BG Foods producing half its products in the Devon factory, Mr Myerson pointed to the fact that all the cheese for the cheesecake produced in Devon (which, relying on Mr Glover's report, Mr Myerson estimated to be nearly 45% of the total value of goods produced) was imported, and that this fact had not been analysed by Mr Glover. We find that unsurprising. The source of the raw materials from which food products are manufactured is irrelevant to the question whether what a company does is production or wholesaling. We reject Mr Myerson's submissions in this regard.

172. We do not consider that Mr Glover's selection of six companies from the Food Producers sector as a whole can be criticised. As appeared from Mr Glover's evidence, that selection was random; he was not at that stage seeking to identify companies that had particular similarities with BG Foods. Mr Glover accepted that this involved a major assumption that the sample would be representative of the sector as a whole, but the selection did take a range of companies; two large companies in the index, and four smaller companies more comparable in size to BG Foods. In the absence of a range comparable takeover bids that could be analysed, Mr Glover, like a prudent purchaser would be, was driven to considering the available evidence that was available, namely the minority quoted value that could be obtained from the stock exchange index.

173. Once the six companies had been chosen as proxies for the sector as a whole, Mr Glover compared those companies to BG Foods to ascertain whether the trading record and growth prospects of BG Foods would be considered as against the average for the purpose of attaching a notional stock market rating to it within the Food Producers sector. That, in our view, was an entirely acceptable method of seeking to ascertain the relevant notional quoted P/E ratio as part of the overall valuation exercise.

## Valuation of Mrs Foulser's 9% shareholding

174. Because of the methodology adopted by Mr Glover, the discussion above on the criticisms of Mr Glover's overall approach are equally applicable to the valuation of the minority holding as they are to the majority valuation.

175. As well as those points, Mr Myerson criticised the use by Mr Glover of the earnings basis of valuation for a 9% holding. He referred in this respect to what Mr Glover had said in his book, at para 9.7, namely that "Generally speaking, earnings are the appropriate basis for valuing controlling shareholdings, but not for valuing minority interests." As a general matter that seems to us to be correct. But it is only a general statement. It does not, in our view, preclude a suitably discounted valuation of a minority based on an entirety value calculated in the same way as for a controlling interest. That is especially so where, as in this case, the company is not

paying a dividend, but has been the subject of a number of bid approaches. What matters is the level of discount to reflect the fact that the holding is a minority one.

### Conclusions on valuation methodology

176. On the basis of the conclusions we have reached on the experts' individual valuations, we prefer the approach of Mr Glover, both as respects Mr Foulser's 51% shareholding and Mrs Foulser's 9% shareholding.

177. We consider that the maintainable earnings approach of Mr Spence is too problematic to be regarded as a reliable valuation method on its own, as evidenced in our view by the flaws we have found in the application of that approach in this case. Furthermore, for the reasons we outlined, we do not consider that the PCPI is an appropriate means of ascertaining a capitalisation factor when compared with the stock exchange P/E ratios. With respect to the valuation of the minority holding, we consider that, where a company is not paying dividends, and has had a number of bid approaches, a properly discounted earnings basis is more appropriate than a dividend yield basis.

178. We accept that the valuation method adopted by Mr Glover has some difficulties, involving the exercise of judgment which may lead to different conclusions being reached by different valuers. Thus, judgment is required in the choice of industry sector and the companies within it to represent the sector as a whole, the appropriate P/E ratio for the company having assessed its prospects against those comparables, the bid premium to arrive at an entirety value, and the respective discounts for a 51% and 9% holding. But those are matters of application that do not in our view undermine the approach. In this case we are not asked to adjudicate between different applications of the same methodology, but essentially to choose between methodologies. For the reasons we have given, we consider that Mr Glover's approach is to be preferred.

### Further discussion of the application of Mr Glover's methodology

179. Our finding that Mr Glover's approach is to be preferred over that of Mr Spence does not conclude matters. We need to review certain elements of the way Mr Glover has applied that methodology, both in respect of the valuation of the 51% holding and the valuation of the 9% holding. In particular, we must consider the extent to which Mr Glover was right to take into account in his valuation the October 1997 offer.

*Control premium*

180. Having arrived at an "as quoted" P/E ratio for BG Foods of 15, Mr Glover then applied a control premium of 40% to arrive at a control P/E ratio of 21, from which Mr Glover then calculated the entirety value of £40,467,000.

181. In his report, Mr Glover referred to empirical studies having shown that "most bid premiums tend to fall within 30% and 50% of the pre-bid share price". We did not have any evidence of the studies to which Mr Glover was referring, but the PCPI

newsletter produced by BDO Stoy Hayward (Issue 2, 1999), which was part of Mr Spence's report, does refer to generally to takeovers and "public-to-private MBOs of smaller quoted companies enabling a premium of 30% – 50% on the quoted price being realised". The references relied upon by Mr Glover in his report, which were from the November 1997 edition of *Acquisitions Monthly*, disclosed an average bid premium of 35% for the third quarter of 1997, 29% for the second quarter and 42% for the first quarter. In light of that information, we do not consider that a prudent purchaser in November 1997 would have adopted a figure as high as 40%. We consider that the control premium should be set at 35%, which is of course in the range of 30% – 50%. That will result in a control P/E ratio of 20.25, and an entirety value of £39,021,750.

*Entirety value*

182. Having arrived at an entirety value by reference to our own conclusion as to the appropriate control P/E ratio, we must turn to the submission of Mr Myerson that Mr Glover's entirety value of £40,467,000 (and by extension so too our entirety value) was anomalous having regard both to the October 1997 offer and the Mermaidlogic transaction in November 1998.

183. Mr Myerson argues that a comparison of the entirety value arrived at through Mr Glover's valuation methodology with the figures obtainable from both the October 1997 offer, when considered in conjunction with a likely price for the 40% shareholding of KEL, and the overall price paid by Mermaidlogic to acquire 100% control of BG Foods shows that the entirety value is anomalous.

184. What Mr Myerson has done, both as regards the October 1997 offer and the Mermaidlogic deal, is to aggregate the price offered or paid for the 60% shareholding of Mr and Mrs Foulser, with that expected to be paid or paid for the 40% holding of KEL. In the case of the October offer, the figures, from the evidence, are in the region of £26 million for the Foulsers' shares and £7 - 8 million for KEL's shares, a total of £33 – 34 million. For the Mermaidlogic deal, the figures are: the Foulsers' shares, £27,348,482; for KEL's shares, £8,560,387, a total just short of £36 million. Faced with these figures, how, Mr Myerson asks, even assuming that the offer and the Mermaidlogic deal are relevant (an issue we shall address below), can one arrive at an entirety value of £40 million?

185. The answer, in our view, is that the entirety value is not attempting to aggregate assumed values for individual parcels of shares. It is merely a step in a process that translates a quoted P/E ratio that relates to small minority holdings of shares into an entirety value by applying a control premium. That gives an entirety value which a purchaser can be assumed to pay if it is purchasing the whole company for a price which values the company as a whole and takes no account of reduced values for holdings of less that 100%. It effectively eliminates any discount that would be inherent in any valuation of a holding less than 100% and inherent in the quoted P/E. To the extent they are relevant, those discounts can then be applied in reducing the pro rata value of each holding making up the entirety of the company.

186. There is thus no comparison between the entirety value and the aggregation of interests which, to a greater or lesser extent, will have included a discount to reflect the size of the holding. The entirety value arrived at using Mr Glover's methodology, with our own adjustments, is therefore not undermined by reference to the October 5 1997 offer and the Mermaidlogic deal.

*Discount for 51% holding lacking full control*

187. Mr Glover's opinion was that, in a case where the company in question was mature and its trading performance average or pedestrian, the inability of the holder of a 51% holding (as opposed to the holder of a 75% holding) to pass a special resolution 10 might have little practical significance. In such a case, Mr Glover's view was that a discount for lack of full control of around 10% would be appropriate.

188. However, in the case of an expanding company in a phase of strong growth, Mr Glover expressed the view that the lack of full control "can be irksome and inconvenient", and that in such a case there were good arguments for putting the 15 discount somewhat higher, at say 15%. On this basis, Mr Glover employed a discount of 15% from the full pro rata value of Mr Foulser's shareholding to reflect the lack of full control.

189. Mr Spence took a different view of the level of discount. He referred to the difficult position in which Mr Foulser had found himself following the acquisition by 20 KEL of its 40% holding (a holding sufficient to block the passing of a special resolution), and his failure to procure agreement from Mr Ashness on a sale of the 60% on terms satisfactory to him. Mr Spence's view, relying on the range of at least 20% to 25% described by the authors of *Practical Share Valuation*, was that a discount of 20% was appropriate.

25 190. The level of discount is a matter of judgment in the circumstances of each case. Views may differ as between valuers, not only as to the level of discount in a particular case, but also as to the range of discounts. In this instance, we prefer Mr Spence's view. Although a prospective purchaser would not have inherited the particular difficulties of Mr Foulser, it is nevertheless a relevant consideration for 30 such a purchaser that the 40% holding was in the hands of a single shareholder which could therefore on its own block a special resolution. That is different from a case in which the minority holding is held more widely such that no one shareholder, or single shareholding group, can block such a resolution, and in our view merits a higher discount than that adopted by Mr Glover. As any purchase might require an 35 element of restructuring, the presence of such an interest would be a factor taken into account by a prudent purchaser. We consider that a discount of 20% is appropriate in this case.

191. On this basis, and taking our revised entirety value of £39,021,750, that gives a pro rata value of a 51% holding of £19,901,092. Applying a 20% discount for lack of 40 full control gives a value for Mr Foulser's holding, before taking account of the effect (if any) of the October 1997 offer, of £15,920,873.

*Minority holding discount*

192. In his report, Mr Glover stated that an interest of 9% would normally attract a discount of around 50% of the pro rata entirety value. However, in this case he judged that a lower discount (40%) was appropriate. He based this on two factors, the fact that BG Foods was a relatively young business in a strong expansion phase and that a number of bid approaches had been received.

193. We do not consider that these are factors that would justify a reduction in the discount for a minority holding. Each of those factors had been taken into account already. The strength of the company was taken into account in fixing the "as quoted" P/E ratio (which assumes a minority holding). The bid approaches factor is reflected in the use of the earnings basis for the minority interest. To adopt these factors in setting the discount for a minority holding would, in our view, introduce an element of double counting. We consider that the discount should be 50% which, taking account of the revised entirety value of £39,021,750, gives a value for a 9% holding of £1,755,978, before taking into account the October 1997 offer.

*The October 1997 offer*

194. As Mr Gibbon and Ms Dewar acknowledge in their written closing submissions, the significance of the indicative offer of 29 October 1997 lies in the effect it would have had, if any, on the assessment of value by a prudent prospective purchaser. It was submitted that the specific question in this regard is whether the offer would have been viewed as credible by a prudent prospective purchaser as at the valuation date on the basis of he information available to them.

195. We do not accept that the question is simply one of credibility. Mr Glover's conclusions as to the effect of the offer on the valuations of Mr and Mrs Foulser's shareholdings did not rest solely on credibility, but on Mr Glover's assumption that the offer was being seriously considered and stood a good chance of acceptance, and that the offer would have been viewed as likely to succeed. That is a higher threshold than one based on credibility alone.

196. In their written closing submissions, Mr Gibbon and Ms Dewar have invited us to make a number of findings of fact which they submit support their argument that the offer was a credible offer and as such are relevant to Mr Glover's valuation. We list those suggested findings here before commenting on them below:

(a) As at the valuation date (i) KEL was willing to sell its shares for £5m - £10m, and (ii) Mr Foulser knew this.

(b) As at the valuation date (or shortly thereafter) Mr Foulser was confident that a profit of £4.5m would be achieved for the 1997/98 financial year under "normal trading conditions" (by which was meant in particular taking out of account the difficulties experienced by Devon Desserts in the summer and autumn of 1997). That was realistic and achievable.

(c) As at the valuation date, Mr Foulser thought the offer was credible.

(d) The sole purpose of Mr and Mrs Foulser's trip to the Isle of Man on 7 November 1997 was to put in place a scheme to mitigate CGT on the sale of their shares in BG Foods.

(e) By the valuation date, Mr and Mrs Foulser had decided to sell their shares in BG Foods.

(f) Mr Foulser seriously considered the offer.

(g) The indicative offer of 29 October 1997 and the subsequent sale of BG Foods to Mermaidlogic were part of a single indivisible process leading to a deal.

(h) The price paid by Mermaidlogic was an arm's length price which was reached following a process of negotiation and careful investigation.

(i) 3i's existing investment in KEL had no identifiable impact on the £27m consideration either during negotiations or on the ultimate purchase by Mermaidlogic.

(j) 3i was an experienced and prudent investor and the price paid was reasonable in all the circumstances.

(k) The price paid by Mermaidlogic was paid after lengthy enquiry and detailed due diligence.

(l) The Frostie report was prepared with great care by the new management, and set out their realistic plans for the future of the business.

(m) There is no reason to conclude that the management's forecasts were unrealistic of unreasonable at the time they were made in the summer of 1998.

197. We do not consider that the views of Mr Foulser are material to the question of valuation for this purpose. The subjective positions of the real participants are irrelevant in the context of a valuation exercise which assumes both a hypothetical seller and a hypothetical purchaser. The most that can be said of Mr Foulser is that, if the offer had come to fruition, he would have been a willing seller; but that adds nothing to the statutory hypothesis.

198. Thus, Mr Foulser's own views on the credibility of the offer are irrelevant. So too are the actions taken by Mr and Mrs Foulser which suggest that they would have been willing to sell at the price, and on the terms, set out in the offer. We have found that one of the purposes of Mr and Mrs Foulser in visiting the Isle of Man in November 1997 was to consider CGT planning on a sale of their shares. But we do not consider that this can affect the view a prudent prospective purchaser would have taken of the offer. Such a purchaser would not have been privy to the private tax discussions of Mr and Mrs Foulser. In any event, such tax planning can do no more than suggest that Mr and Mrs Foulser would have been willing sellers.

199. That, we consider, deals with paragraphs (c), (d), (e) and (f). It also deals with the subjective elements of paragraphs (a) and (b), but those paragraphs also require examination on an objective basis. The findings which Mr Gibbon and Ms Dewar

argue for in (a) and (b) go, they submit, to support the credibility of the offer, as the prudent purchaser would have been able to conclude that the conditions in the offer as to profitability and the acquisition of KEL's shareholding would not have presented an obstacle to a sale on the terms of the offer.

5 200. As regards profitability, we consider that the assessment of the offer by a prudent purchaser on the valuation date must be by reference to the terms of that offer as they were available on that date, and not the terms as they were subsequently revised. The profit assumption in the offer letter required that the profit before tax for the year ending 30 April 1998 would be at least £4.7 million. No reference was made
10 at that stage to any adjustment for the production difficulties at Devon Desserts. It was only later that Mr Foulser negotiated a different condition, requiring profits of £4.5 million under "normal trading conditions". Therefore, although we agree, for the reasons we have explained at [140], that the revised condition could reasonably have been considered to be achievable, that revised condition was not the one which the
15 prudent purchaser would have been considering. Our analysis, based on the figures we have summarised at [140], is that having regard to the costs associated with the production difficulties, a realistic forecast, as at the valuation date, of the profit for the year ending 30 April 1998 would have been £4.3 million (that is, after deduction of the costs of £500,000 from the normalised profit of £4,807,000). On this basis, a
20 prudent purchaser would have concluded that the original profitability assumption of £4.7 million was not capable of being satisfied, and that some re-negotiation would have been required, leading to uncertainty, at least as to price.

201. As regards the acquisition of KEL's shareholding, the offer assumed only that the purchaser could negotiate separately with 3i and Mr Ashness. No assumption was
25 made as to the terms on which a transaction might be achieved with those parties or indeed whether any such transaction would be achieved at all.

202. The hypothetical prudent purchaser would have information concerning the relationship between Mr Foulser and KEL and KEL's shareholders, 3i and Mr Ashness. He would also be aware of the various discussions that had taken place
30 between those parties regarding the resolution of the difficulties that had arisen. On the basis of that information, although there would have been no reason for a prudent purchaser to doubt that separate negotiations could take place with 3i and Mr Ashness, we do not consider that such a purchaser would have been able to judge whether such a sale would be possible or at what price.

35 203. Although Mr Foulser had been having discussions with both 3i and Mr Ashness for some time, the evidence does not show that those discussions had, by the valuation date, reached a point at which any realistic appraisal of the likelihood of a transaction taking place could be made. Mr Gibbon and Ms Dewar, in their written closing submissions, have pointed to the position at the time of the offer of 29 October 1997
40 being that 3i had suggested a value of £10 million for the 40% holding of KEL. That submission is based on Mr Whiteson's note of the meeting between Rooks Rider and 3i on 13 October 1997. In our view, however, that note tells a different story.

204. First, it is clear that the sale of the minority interest was only one of the possible options considered by 3i to be open for consideration. The options referred to by 3i were: (i) buying Mr (and Mrs) Foulser out; (ii) selling the minority stake to Mr Foulser; (iii) selling BG foods in its entirety; (iv) listing BG Foods; (v) 3i being bought out; and (vi) doing nothing. The view of 3i was that (i) and (ii) (that is including the sale of KEL's shares) were perceived to be difficult having regard to the extensive discussions that had already taken place between 3i and Mr Foulser.

205. Secondly, the estimate of £10 million for the whole minority stake was given on the express basis that 3i was not speaking for Mr Ashness or for KEL. That estimate was based on 3i's guess that the pre-tax profits of BG Foods would be "in excess of £3 million" and after tax profits would be around £2.2 million. The estimate was arrived at by applying an historic post-tax multiple of 12 to those post-tax profits, whilst recognising that some discount for a minority holding would be appropriate. It was emphasised that this was only a rough estimate and that information about the current year's trading would be needed. This would, as we have described, have shown that 3i's estimate of profits was conservative.

206. We do not consider that a prudent purchaser could have reached any conclusion as to the likelihood of KEL being willing to sell its stake in BG Foods for between £5m and £10m. That was a possibility, but no more than that. It was equally possible, and we consider that a prudent purchaser would have taken this view, that 3i's negotiating position would have hardened once it became aware of the profit projections for 1997/98 and that it was dealing with a purchaser prepared to offer £26 million for a 60% shareholding.

207. None of this in our view provides any support for the credibility of the October 1997 offer. Still less would it have led a prudent purchaser to conclude that the offer was likely to succeed. Despite the initial work that had been put into the numbers in order to arrive at the indicative offer, Mr Hemming's evidence, which we accept, was that if he were advising a seller in this respect, he would counsel them that, having regard to the information on which it was based, it should not be relied upon as a deliverable offer. It was standard fare that Arthur Andersen would have "bashed out" in order to try to move things on to the next stage. That, we find, was the status of the indicative offer in this case. In our view, the prudent purchaser would have reached the same view of the offer as we have done.

208. We turn now to the remaining findings that Mr Gibbon and Ms Dewar invited us to make, namely paragraphs (h) to (m). From the perspective of the prudent purchaser in possession of the October 1997 offer and other information available at the valuation date, none of what transpired after that date could have influenced his assessment of the price to be paid. Thus, even if it were the case that the sale to Mermaidlogic was simply the culmination of a single indivisible process which included the October 1997 offer, that factor is not in our judgment relevant to the calculation of the values of the relevant holdings at that date. Its only relevance would in our view be as a cross-check of the valuation made on the basis only of the information available on the valuation date.

209. Having said that, we do not accept that there was a single indivisible process of the nature suggested by Mr Gibbon and Ms Dewar. Although there is an element of cross-over in the identities of some of the parties – 3i and Mr Kingston, until he dropped out of the picture – and advisers, and we accept that the heads of terms which were signed by the parties including Mr Kingston remained the basis for discussions after he was replaced as chief executive designate by Mr Stainow, and that due diligence undertaken before Mr Kingston's departure was built upon by the Mermaidlogic deal, the crucial difference in our view – and what separates the deals – is the fact that the principal equity provider changed. The original proposals were on the basis of a principal equity participation of Kleinwort Benson, at which time, although it was also to provide equity, 3i's potential involvement was as a seller. That changed when Kleinwort Benson dropped out, and 3i became the principal equity-provider, and thus a purchaser rather than a seller.

210. We have no evidence as to why Kleinwort Benson ceased to be involved. We had very little evidence at all as to Kleinwort Benson's involvement. We do not know if Kleinwort Benson would have been prepared to finance an acquisition of BG Foods on the same terms as 3i ultimately did. In our view, the positions of Kleinwort Benson and 3i were different in a material respect. 3i had an existing interest in BG Foods through KEL, whereas Kleinwort Benson had no such interest. The relationship between Mr Foulser and the other shareholder in KEL, Mr Ashness, was a difficult one. 3i's interest was in a 40% minority holding in a company where the other 60% was controlled by Mr and Mrs Foulser, but which, because of the dispute between Mr Foulser and Mr Ashness, had ceased to pay any dividends, and in which neither KEL nor 3i had any board representation.

211. This means, in our view, that in the circumstances of the transaction whereby Mr and Mrs Foulser's shareholdings were acquired by Mermaidlogic, 3i must be regarded as a special purchaser, and that the Mermaidlogic deal falls to be treated as a special purchase and not as merely the end result of the process commenced by the indicative offer. The commonality of the price achieved on the sale to Mermaidlogic with that initially proposed in the October 1997 offer is readily explained by the fact that it was the price at which Mr Foulser had said that he was prepared to consider selling. It was only Mermaidlogic, with the equity participation of 3i, that actually did a deal on that basis.

212. As Mr Gibbon and Ms Dewar submit, there is no direct evidence of 3i's internal processes, and Mr Hemming's evidence was only that, as would be expected, the deal was approved by 3i's internal investment committee. Accordingly we can make no findings as to the particular reasons why 3i were prepared to go ahead on the basis of the Mermaidlogic deal. But we do not need evidence of the rationale of 3i in completing a particular deal to conclude that, by virtue of the particular position in which 3i found itself as a shareholder in KEL, 3i was not in the same position as Kleinwort Benson. The deal proposed by the offer and the eventual Mermaidlogic deal, although they shared certain characteristics, were separate transactions. Neither the fact that the Frostie Report was diligently prepared, nor that management's forecasts at the time they were made were not unreasonable, provide any support for

the single indivisible process analysis. The Mermaidlogic deal does not provide any support for the proposition that the offer was credible, or likely to succeed.

213. The fact that Mr Foulser himself would have been unwilling to sell for a lower price than was achieved on the actual sale to Mermaidlogic is not a relevant factor in the valuation, since it must be assumed that the seller is a willing seller. Nor does the fact that a purchaser in the position of 3i was willing to purchase the shares on the terms of the Mermaidlogic transaction indicate that, at the valuation date, a hypothetical purchaser, not in that position, would have been willing to purchase on similar terms. Furthermore, in view of the special circumstances of the relationship between Mr Foulser and KEL and 3i, a prudent purchaser would not have made any assumption as to the willingness of 3i, as a special purchaser, to do such a deal once the difficulties had been removed by the exit of Mr Foulser from the business.

*Effect on Mr Glover's valuation*

214. We have decided, contrary to the assumption made by Mr Glover in his report, that a prudent purchaser would not have regarded the October 1997 offer as likely to succeed. The evidence of Mr Glover is that " [if] the Tribunal finds as a fact that [the offer] had no credibility whatsoever" then the respective holdings of Mr and Mrs Foulser would be valued without any uplift to take account of the offer price of £26 million.

215. As we have described, the question is not in our view one of credibility, but of the view that would be taken by the prudent purchaser of such an offer leading to a sale of the shares at that price. For the reasons we have given, the prudent purchaser would not have assumed that the offer was likely to succeed. We do not take the view that in those circumstances the offer should be disregarded. But we consider that the prudent purchaser would have regarded the terms of the offer as no more than a useful cross-check of the price he was prepared to pay, and not as resulting in any additional premium on that price.

## Summary of conclusions

216. We have concluded that Mr Glover's valuation methodology is to be preferred over that of Mr Spence. However, we take the view that certain adjustments should be made to Mr Glover's valuations both in respect of Mr Foulser's 51% holding and the 9% holding of Mrs Foulser.

*Mr Foulser's 51% holding*

217. Mr Glover used a control premium of 40% to arrive at a control P/E ratio of 21 and an entirety value for BG Foods of £40,467,000. We have concluded that a prudent purchaser would have used a control premium of 35% and thus a control P/E ratio of 20.25. The entirety value on this basis is £39,021,750.

218. Taking this entirety value, and adopting Mr Glover's methodology, a 51% pro rata value is £19,901,092. We consider that Mr Glover's discount of 15% to reflect

the lack of full control in the case of a 51% interest is too low, and that 20% is the appropriate level of discount. On this basis we have arrived at a value for the 51% holding of £15,920,873.

219. We have determined that there should be no uplift in this value to reflect the terms of the October 1997 offer. Accordingly, we find that the market value for CGT purposes of Mr Foulser's 51% shareholding in BG Foods on 24 November 1997 was £15,920,873.

*Mrs Foulser's 9% holding*

220. Mr Glover applied a discount for Mrs Foulser's minority interest of 40%. We have decided that a discount of 50% is appropriate. On the basis of an entirety value of £39,021,750, that gives a value for a 9% holding of £1,755,978.

221. As there is no uplift in value to reflect the terms of the October 1997 offer, we find that the market value for CGT purposes of Mrs Foulser's 9% shareholding in BG Foods on 24 November 1997 was £1,755,978.

## Decision

222. Those are our determinations of the market values for CGT purposes of Mr and Mrs Foulser's respective shareholdings in BG Foods. We expect that the parties will be able to agree what effect these determinations have on the amendments to the self assessments of each of Mr and Mrs Foulser for the tax year ended 5 April 1998. However, the parties have liberty to apply in case of disagreement, and these appeals are adjourned for that purpose. Any application to the Tribunal in that respect must be made not later than two months from the date of release of this decision, subject to any further direction.

## Application for permission to appeal

223. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

**ROGER BERNER**
**TRIBUNAL JUDGE**

**RELEASE DATE: 30 April 2015**