

The Newsletter from The Network of Independent Forensic Accountants

THE 'QUASI-PARTNERSHIP' QUESTION



In the valuation of family businesses the quasi-partnership question and the issue of minority discounts can often be the most significant factor in terms of its financial effect.

The valuation of shares will inevitably be a subjective exercise whether for the purposes of litigation in divorce, shareholder disputes or unfair prejudice actions. However, even if each side to a dispute appoints its own forensic accountant to undertake a valuation, the chances are that, assuming both valuers follow generally accepted valuation principles, their respective valuations should differ by no more than 30 - 40%.

Once a value of a company has been established, the assessment of the value of any shares therein causes one to have to consider whether or not a minority discount should be applied. Because discounts for small minority holdings can be as much as 90% or more, these can have an enormous impact on overall quantum.

Continued inside

NIIFA WELCOMES A NEW MEMBER
Fiona Hotston Moore, Ensors, Ipswich

In this issue:

MAXIMISING COMPENSATION FOR MIS-SOLD INTEREST RATE HEDGING PRODUCTS

It is possible to claim consequential losses in addition to interest.

SECTOR 'SEXPERTISE'!

An unusual case where sector expertise was best presented as being purely desk-top research based.

MAXIMISING COMPENSATION FOR MIS-SOLD INTEREST RATE HEDGING PRODUCTS ('IRHPs')

In 2012, the Financial Conduct Authority ('FCA') identified failings in the way that some banks sold IRHPs and implemented a scheme by which customers could receive compensation.

So far the banks have sent offers of cash compensation to 13,500 customers, of whom around 8,000 have accepted the offers, and a colossal £1.2 billion is being paid out.

In addition to a refund of interest and charges, the banks are required to compensate customers for consequential losses arising from the mis-selling. The FCA introduced a generous flat rate of interest on compensation payments of 8% per annum that it intended should be a 'straightforward and fair alternative' to making claims for consequential losses.

'simple interest, even at 8%, is inadequate'

However many affected businesses consider that simple interest, even at 8%, is inadequate to compensate them fully. For example, we are aware of businesses that claim that the effect of the IRHPs was to starve them of working capital and in some cases to force them to sell assets in a distressed sale scenario.

If a claim for consequential loss is to succeed it must overcome the usual legal tests of causation and recoverability. If and when these hurdles can be overcome, it is next necessary to consider whether the loss arose because the customer was deprived of the funds that were used to meet the payments under the IRHP. In most cases it will have been this deprivation that caused the loss. Such cases are typically framed in terms of the claimant saying that had it not had to have used the funds to meet payments under the IRHP, it would have invested them in the business in particular so as to generate the profits that it has foregone and for which it seeks compensation. Such compensation will be payable instead of the 8% interest.

By contrast, there are some cases in which the loss arose as a result of the IRHP where it was not caused by the deprivation of funds. In that scenario compensation for the consequential loss can be claimed in addition to the 8% interest.

'consequential losses can be claimed in addition to interest'

An example of this type of case might arise because the IRHPs often included exit penalties that were taken into account, even if not triggered, in the calculation of customers' loan to value ratios. If such ratios tipped so as to imply that customers had borrowed too much, the banks often demanded that overdrafts be reduced and loans be repaid. If these enforced gearing reductions can be shown to have damaged customers' businesses and to have been a direct consequence of the IRHP, compensation for the consequential losses can be claimed in addition to interest.

Often customers are asked to choose whether they wish to claim interest at an early stage in the compensation process and care needs to be taken to ensure that the simple act of ticking the wrong box on a form does not preclude them from later claiming damages for which they would otherwise have been entitled. Early, even if approximate, estimation of consequential losses is therefore essential as is the determination as to whether such losses can be claimed in addition to or as an alternative to interest.



Will you be claiming interest at 8%
 Yes & I'll also pursue you for consequential losses

THE 'QUASI-PARTNERSHIP' QUESTION

continued from page 1

In simple terms if one valuer values a company at £1million and another values it at, say, £1.5million, a 10% shareholding therein would be worth £100k on the basis of the first valuation and £150k on the basis of the second. The question as to whether to apply a minority discount of, say, 90% on the one hand or to apply no discount on the other, on the grounds that the company is deemed to be a quasi-partnership, has a larger effect on the overall valuation than the difference between the headline values.

It is therefore perhaps not surprising that the terms of share valuation instructions to forensic accountants increasingly ask for the expert witness to provide an opinion as to whether or not the company under consideration is a quasi-partnership. Clearly that decision will ultimately be a matter for the court. However there is nothing to prevent an accountant from providing evidence to the court to assist it in reaching its decision. The way in which that evidence is provided is also often very influential if cases settle before trial, especially if it has been given by a single joint expert.

Although deciding whether or not a given business might qualify as a quasi-partnership will ultimately be a matter of professional or judicial judgment, there are a number of indicators that can inform the decision, as follows:

1. The existence of non-shareholder directors

Typically, a quasi-partnership will be a company in which all the directors are shareholders or, if there are shareholders who are not directors, they will usually be close family members of the directors who hold shares for tax planning purposes.

Conversely, the existence of non-shareholding directors and non-executive directors tends to indicate that the company is run on more corporate lines and is less like a partnership.

2. A close working relationship between directors

An indication of quasi-partnership will be a close working relationship between directors and a hands-on management style in which all shareholder directors are closely involved in day to day management decisions.

3. An absence of a formal shareholders' agreement

A key feature of partnership ought to be a high level of trust between the partners. For that reason, companies that operate without formal agreements between shareholders as regards matters such as the payment of directors' remuneration and dividends are often said to exhibit features of a quasi-partnership.

4. Funding by directors

Most partnerships are funded to a significant degree by their partners. For that reason, companies that have been lent significant sums by shareholder directors share a common attribute with partnerships.

5. Funding of directors

Often partnerships will fund personal expenditure of partners, with such expenses being debited to the relevant partners' capital accounts. By analogy, companies that meet the personal expenses of directors and account for this through directors' loan accounts tend to be seen as operating on more of a quasi-partnership basis than a corporate basis.

6. Size

There is probably a limit to how large a quasi-partnership can be because companies beyond a certain size tend to adopt a corporate persona that is incompatible with partnership. Conversely a quasi-partnership is typically of a size commensurate with a family undertaking as opposed to a large corporate enterprise.

By considering each of these factors, together with anything else that might be relevant to the particular circumstances of the case, the forensic accountant can present evidence as to which of the 'badges of partnership' are present, in an effort to answer the vital quasi-partnership question logically, as objectively as possible and in a manner that can withstand cross-examination.



NIFA Accredited Forensic Accountants

Adam Stronach Harwood Hutton Ltd
Beaconsfield, Buckinghamshire
01494 739500

Johnny Webb, Webb and Co
Belfast, County Antrim
02890 918499

Roger Isaacs Milsted Langdon LLP
Bristol, Taunton, & Yeovil
0117 945 2500

David Muggridge Ackland Webb Ltd
Canterbury
01227 811745

Chris Hatcher Watts Gregory LLP
Cardiff
029 2054 6600

Phil Ewing Harrison, Beale and Owen Ltd
Coventry
024 7663 1303

David Winch Accounting Evidence Ltd
Cumbria
01229 716651

Kate Hart Roffe Swayne
Godalming, Surrey
01483 416232

Fiona Hotston Moore Ensors
Ipswich
01473 220034

Raymond Davidson Bartfields
Leeds
0113 244 9051

Bee Chew Wilder Coe LLP
London (NW1)
020 7724 6060

Brian Spence BTMR Ltd.
Manchester
0161 300 3458

Clive Adkins Kilby Fox
Northampton
01604 662 670

Peter Smith Quantis
Northumberland
01670 511 999

Martin Berry Hobsons
Nottingham
0115 962 1590

Melvyn Sobell & Michelle Fisher
Sobell Rhodes LLP
Pinner, Middlesex
020 8429 8800

Philip Allsop Barber Harrison & Platt
Sheffield
0114 266 7171

Norman Cowan Wilder Coe LLP
Stevenage
01438 847200

Martin Jackson Jackson Calvert
Sutton Coldfield
0121 355 0404

John Kenny, Providence Forensic
Accounting Experts Ltd, Wicklow, Eire
00 35340461033

SECTOR ‘SEXPERTISE’!

Forensic accountants are often asked what sector expertise they have that qualifies them to give their valuation opinions, but in a recent case involving a company that published to internet subscribers videos with a female domination theme, both the forensic accountant for the claimant, a NIFA member, and the forensic accountant for the defendant were keen to emphasise that their industry expertise was based purely on desk-top research.

The claimant sought an order to set aside a transfer of shares on the grounds that he had been subject to duress. The judge pertinently observed that “assessing the credibility of a claimant who has a fetish for female domination and claims to have been the victim of duress and intimidation by his female partner is not easy. Assessing the credibility of a defendant who denies threatening behaviour, but who has made a career as a dominatrix and appearances in female domination videos is not easy, either.”

‘the NIFA member’s evidence was sufficient to value the company at an amount more than sixteen times the mid-range valuation of his forensic accounting opponent’

Ultimately we are pleased to be able to report that the NIFA member’s evidence was sufficient to persuade the judge to value the company at the centre of the dispute at an amount close to the figures he had advanced and more than sixteen times the mid-range valuation of his forensic accounting opponent and they didn’t even have to give evidence in the hot tub!

