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THE HIGH COURT

2001 168 COS

IN THE MATTER OF W. AND R. MORROUGH (IN RECEIVERSHIP) AND

IN THE MATTER OF THE STOCK EXCHANGE ACT 1995

BETWEEN

TOM GRACE

APPLICANT

AND

JAMES SHEEHAN AND HUGH HALL AND BARBARA HALL

RESPONDENTS

JUDGMENT of Mr. Justice Roderick Murphy delivered the 21st day of March 2011

1. Motion
This motion dated the 9th September, 2010, was heard on the 18th January, 2011. The applicant, as Receiver, sought a number of orders and directions in relation to the date of valuation of shares held by or to the order of W. & R. Morrough, the above mentioned firm of stockbrokers, in circumstances where those shares had been sold by that firm without the clients' authorisation.

On the 9th September, 2010, the court had ruled that the interests of clients who claimed against the client bank account of the firm in relation to the wrongful sale of the shares was to be represented by Mr. James Sheehan, the first named respondent, who is one of the firm's clients.

The interests of clients who would cash claims against the firm's bank account was agreed to be represented by Mr. Hugh Hall and Mrs. Barbara Hall, the second named respondents who were also clients of the firm.

2. Previous Proceedings
These parties, among others, had already made submissions to the hearing by this Court in 2003 regarding the distribution of shares held on the order of the firm. The court heard opposing views and made orders on the 6th May and 31st July, 2003. The court declared, in its judgment dated the 6th May 2003, that it was inappropriate to direct that there should be a general pooling of client assets to the firm for the purpose of distributing such assets rateably as between clients of the firm. Subject to the directions in relation to the costs of the proceedings and the fees, costs and expenses incurred by the Receiver, the court further declared that:-

> (a) Clients of the firm on whose behalf shares were purchased by the firm or delivered to the firm were entitled to such shares where the purchases or deliveries, as applicable, had been duly recorded and the books and records of the firm, the shares being identifiable and having not been disposed of.
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> (b) Where insufficient shares were held by or on behalf of the firm to satisfy all of the lawful claims of clients to a particular line of shares, the available shares should be treated as a pool of shares and distributed rateably as between the clients with lawful claims to those shares in proportion to the extent of each such claim.
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> (c) Where there were insufficient shares to satisfy the lawful claims of clients, the clients affected by the shortfall should be entitled to make a claim in respect of the shortfall against the monies in the client bank accounts of the firm, such claims to rank rateably with other clients claims against those monies (which the Receiver referred to as the "Shortfall Shares").
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> (d) The clients with claims to shares which were never purchased by the firm should be entitled to claim against the monies in the client bank accounts of the firm, with such claims to rank rateably with other client claims against those monies, and
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> (e) Where share, the property of the clients, were sold without authority by the firm the claims in respect of those shares or of the sale of those shares should also lie against the monies in the clients' bank account of the firm and should rank rateably with the claims of the other client against the client bank accounts of the firm.

3. Affidavit of Receiver
The grounding affidavit of Tom Grace, the Receiver, averred to the fact that all of the shares in category (a) were returned to the clients of the firm except those shares which were to be sold, with the sanction of the court, to meet the cost of the receivership. All of the shares in category (b) were returned to the clients of the firm rateably with the same exception.

The application for directions before the court, relates firstly to para. (c) – the "Shortfall Shares". Mr. Sheehan represented this category of clients.

Secondly, para. (d) relates to clients whose shares were never purchased by the firm, though the firm had funds to do so. These clients were represented by Mr. and Mrs. Hall.

On the 27th April, 2001, the Receiver was appointed on foot of an application to the Central Bank pursuant to s. 30(1) and 30(8) of the Stock Exchange Act 1995, which provides for the winding up or dissolution, of a stock exchange or member firm unable to meets its obligations to its clients or creditors.

The Receiver averred to the complexity of the receivership, which had raised a number of difficult legal and other issues, which led to the judgment of this Court of the 6th May, 2003, already referred to.

The problems encountered included instances of shares being transferred out of the name of the clients and into the account of Morrough Nominees Limited in CREST without the knowledge or authority of the clients. The pool of shares in CREST were subject to continuous movement with shares being lodged and withdrawn making it impossible in many cases to identify the date when the wrongful sale of shares took place. The Receiver averred that on the date of his appointment as Receiver there were insufficient shares available in the relevant pool of shares to satisfy all of the lawful claims to such shares. In such circumstances it was necessary to identify a method of valuing the shareholding. It was essential to identify the date on which a valuation was to take place.

4. Receiver's Submissions
Mr. Denis McDonald S.C., on behalf of the receiver, submitted that ordinarily, the measure of damages arising out of a wrongful sale of shares was assessed by reference to the date when the wrongful sale took place. He referred to *Solloway v. McLaughlin* [1938] A.C. 247, where a stockbroker had wrongfully sold shares deposited with him by a client. When the client later discovered the wrongful sale ("unauthorised conversion"), the stockbroker bought new shares at a time when the price of the shares was half of what the client had originally paid. The Privy Council held the client was entitled to damages assessed as of the date of the wrongful sale of the shares.

The Receiver submitted that that principle was reaffirmed more recently by the Privy Council in *B.B.M.B. Finance (Hong Kong) Limited v. Eda Holdings Limited* [1990] 1 W.L.R. 409, where shares sold without authority by an agent and the client was held to be entitled to damages assessed by reference to the value of the shares on the conversion.

Sachs v. Miklos [1948] 2 K.B. 23, concerned a claim for wrongful conversion of furniture stored in 1940, sold in 1944 and claimed back in 1946, after the war, when it had a considerably greater value. The claimant failed to keep the first named defendant aware of his whereabouts and having written letters to, and telephoned the claimant without success, sold the furniture. Lord Goddard C.J. (with whom Tuck L. J. and Jenkins J. agreed) held that the first defendant's action did amount to a conversion. If the claimant had received the letters the value of the goods converted was at the date of the sale. If he had not known or ought not to have known that his goods would be sold and did not find out until 1946, it seemed to the court that, however unfortunate for the first named defendant it was not possible to say that he was not entitled to recover the value of the goods at that time.

The Court had, in its judgment of the 6th May 2003, displaced the rule in *Clayton's* case and had adopted a notional basis for such class of claim to be asserted against the clients' bank account. This approach assumed that monies realised from unauthorised sales may have passed through the firm's bank accounts and might comprise a component part of the monies standing to the credit of the accounts. It was submitted that:

> "In circumstances where it is impossible to identify the relevant date of sale, it may well be the case that the most equitable manner in which to approach the issue would be to identify in the first place when the shares were purchased in the client's name and, having identified that date, to identify the highest value shares of that type attained during the period between the date of their acquisition and the date of the appointment of the Receiver . . ."

This appeared to be consistent with the principles of valuation identified by the Privy Council in *Solloway* and in *B.B.M.B*. It was submitted that the underlying logic was that if the relevant date of sale could not be identified with any accuracy, "one could not rule out the possibility that shares were actually disposed of on a date at which they would have attained their greatest value".

The submissions of the Receiver recognised that this would have significant consequences for certain other categories of claimant. The effect of a valuation set out on the basis referred to, would increase the aggregate value of claims for lost shares and reduce the amount of client monies available to meet the claims of clients with cash claims.

Reference was made to Mr. James Sheehan's claim in respect of shares in E.M.C. Corporation. The highest value for those shares during the relevant period was US$102 per share, which would give a valuation of US$32,043. If the shares were to be valued as at the date of the order directing the winding up and dissolution of the firm as of the 21st May, 2001, the value of Mr. Sheehan's claim would be US$12,785.58.

It was submitted that it would be inappropriate for the Receiver to advocate any particular solution to the problem and that the submissions of Mr. Sheehan and Mr. and Mrs. Hall would assist the court in reaching a decision as to the appropriate basis for valuation.

5. Submissions of Mr. Sheehan
Ms. Clohessy S.C. advocated, on behalf of Mr. James Sheehan, that there was a need for consistency in relation to the "Shortfall Shares" referred to. It would be undesirable for dates to be inferred where the recorded information was uncertain.

It was submitted that the fairest and most appropriate way to value the loss to persons who shares were sold without authority was that the shares in any given class should be valued by reference to the greatest value which was attained during the relevant period. It was submitted that this approach should favour the court for the following reasons:-

> "1. It applies a broadly similar rateable valuation to all shares of the same type;
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> 2. It avoids the potential injustice which could arise because of the circumstances under which the original conversation took place.
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> 3. It is not based on a simple arbitrary date, such as the date of the appointment of a Receiver, which had no particular connection with dates in which the court would ordinarily approach the issue of valuation in the case of converted assets.
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> 4. It allows information which is reliable and readily available to be used to value the shares and avoid speculation as to

what an individual shareholder might or might not have done during the relevant period. It was recognised that this could confer a windfall benefit where there was volatility.

> 5. It was submitted that "there is also the very real possibility that the wrongdoer in choosing to realise shares would have sought to do so by reference to those which had performed well at the height of their price, rather than shares of low value which were underperforming."
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> 6. Such an approach, it was submitted, was consistent with the notion that a fiduciary, who agrees to acquire assets and to dispose of them on instruction of his principal, should be answerable not by reference to an arbitrary date, but by reference to his obligation to maximise the benefit for his principal.

The approach referred to was consistent with the general obligation of a trustee to act honestly, diligently and consistent with the principle that one cannot say that an act was done intentionally and wrongly in circumstances where it could have been rightly performed. Reference was made to *In re. Shanahan's Stamp Auctions* [1962] I.R. 386 at 429, where Budd J. held that each party should bear losses proportionately in the absence of direct evidence. Moreover, it was submitted that this approach was consistent with *Solloway* and *B.B.M.B.* insofar as one could not rule out the possibility that the shares were, in fact, disposed of on the day of greatest value.

6. Submissions on Behalf of Mr. and Mrs. Hall.
Mr. O'Moore S.C. referred to *Solloway* and to *B.B.M.B.* and, in particular, to the reliance of the Receiver's submissions regarding damages for conversion exceeding the value of the property of the date of conversion as referred by Lord Templeman at p. 412.

The submissions on behalf of Mr. and Mrs. Hall were that the Receiver's proposed approach was incorrect. It was submitted that damages for conversion may be less than the value of the property at the date of the conversion if the property decreases in value between the date of the conversion and the date when the owner discovers the conversion. While this was not the approach adopted in *Solloway*, it was supported by the decision of Laddie J. in *Malkins Nominee Limited v. Societe Financiere Mirilis S.A.* [2004] E.W.H.C. 2631 at (34) which summarised the principles applicable in measuring damages in conversion as follows:

> "First, damages should be awarded which gives the claimant just compensation for the losses he has sustained. Second, the value of the converted asset is a suitable starting point for determining what the loss is. Third, the value of the converted asset is not necessarily a correct measure of the damages suffered since the claimant may have suffered greater or lesser loss than this."

It was submitted that this was the approach taken by McMahon and Binchy, *Irish Law of Torts* (3rd Ed.) at para. 30.40 – 30.41, where it was stated:-

> ". . . the court should not ignore the effects of inflation or deflation, otherwise the plaintiff would not be restored to the same position as if the tort had not been committed."

Where the value of shares and the date in which they were wrongfully sold is not known the most appropriate basis for calculating the value of the shortfall is to apply the *prima facie* rule in relation to damages for conversion and apply to the shares the value that they most likely had on the date of the wrongful sale. The closest approximation for this value would be the mode value, the number which occurs most often in a data set, since this statistically more likely than any other value to have been the value at which the shares traded on the date of conversion. Alternatively the mean or median values would be more likely to equate to the loss actually sustained than taking the highest value which would necessarily lead to over compensation in most, if not all cases.

7. Decision of the Court
The Court of Appeal in Barlow *Clowes International Banks Limited (in Liquidation) v. Vaughan* [1992] 4 All E.R. 22, had been cited with approval by this Court in its judgment of the 6th May, 2003. In that case Woolf L.J. (as he then was) stated at 42:

> ". . . there is no reason why the principle of equality is equity should not be applied. In order to obtain preference over the ordinary creditors the investor has to rely on equity to trace his monies into the account. Where the circumstances, convenience and justice so dictate, once the monies are in the pool, equity can require them to be treated as being subject to the other investors 'equitable claims on the fund'."

The court is required to apply the principle of "equality is equity" in relation to what was a common misfortune suffered by the clients of the firm.

This Court has already decided that the rule in *Clayton's* case should not apply to shares held by and money standing to the credit of the firm's account. The application of the rule would have greatly benefited those whose money passed through the firm's account in a relatively brief period prior to the appointment of the Receiver. All other claimants against the funds in the accounts would lose out.

The Receiver had referred to complexity of the receivership which had raised a number of difficult legal and other issues. There is no guidance in the Stock Exchange Act 1995 as to how the winding up and dissolution of the stockbroking firm was to proceed and, in particular, as to how claims arising from its dissolution were to be dealt with.

While *Solloway* and *B.B.M.B* provide some principles of valuation, the facts therein are not in any way as complex as in the present case where there are competing interests in the insolvency. It is clear that the principles of wrongful conversion in the simpler type of case can be resolved by the underlying logic that, if the relevant date of sale cannot be identified, the defendant should not profit from its wrongdoing.

The Receiver does not, of course, do anything more than suggest that "it may well be the case that the most equitable manner in which to approach the issue, would be to identify in the first place when the shares were purchased in the client's name and, having identified that date, to identify the highest value shares of that type attained during the period between the date of their acquisition and the date of the appointment of the receiver". The Receiver's submissions supporting that suggested approach is based on a supposition that "one could not rule out the possibility that shares were actually disposed of on a date at which they would have attained their greatest value".

There is, of course, no evidential basis for such a possibility. One could not rule out that shares might in an extreme case have been disposed of on a date at which they would have been at their lowest value.

Moreover, the Receiver acknowledged that such an approach would "have significant consequences for certain other categories of claimant in the receivership". The court is concerned that this approach could lead to inequality as between those with certain types of shares which, in the interim, may have appreciated more in value than other shares. Within this category of competing shareholders the application of equality would require a dampening down of high or an uplift of low prices over the period from which the wrongful conversion took place. The principle of equality suggests some form of averaging.

In the case of Mr. and Mrs. Hall, shares were not acquired, notwithstanding that the funds were there for that purpose. The category represented by them would otherwise lose out to shareholders who claimed maximum value for their shares. Applying the principle in *Clayton's* case would, of course, have given that category proportionately greater compensation than the shareholders represented by Mr. Sheehan.

The highest value that individual shares may have achieved is not, in the view of the court, an appropriate benchmark for valuation. There is no evidence that the shares would, indeed, have been sold at the highest value. Indeed, the court would have to consider whether, indeed, they may have been sold at their lowest value. There is no evidence or suggestion that the partner responsible for the wrongful conversion adopted any consistent approach as to the price in relation to the unauthorised disposal of shares.

The court is not satisfied that there is any probability that the firm would have chosen to realise shares at the height of their value. The submission on behalf of Mr. Sheehan was that there was a "very real possibility" that that was so. There is no evidential basis for such a "possibility" – in any event it does not help the court in assessing proof on the balance of probabilities.

The court is not satisfied either that the firm had any obligation to maximise the benefit for any of its principals. The function of a stockbroker is to act as broker or agent. There is no evidence that the advice of the firm had been sought or that the partnership members were acting in any way as trustees for the principal. To the extent that they were fiduciaries, they owed an obligation to each and all of their clients. That is now the obligation of the Receiver and requires to be assessed on the principles of equity. Subject to those principles, the price needs to be determined in a pragmatic manner to facilitate implementation by the receiver.

The submission in respect of maximum price does not have regard to the rights of other claimants. It would be inequitable for a distinction to be made between Mr. Shanahan who held shares and Mr. and Mrs. Hall who, at the time of the appointment with the Receiver, had not been the holder of shares to be disadvantaged further.

An analysis of the spread sheet referred to in the affidavit of Frank Kelleher, Solicitors on behalf of the represented parties, Mr. and Mrs. Hall, shows a shortfall in value of Mr. Sheehan's shares to a maximum of US$32,863, and a minimum of US$6,888 over the relevant period. This indicates significant fluctuations from minimum to maximum. The mean, median and mode values are US$18,360, US$19,362 and US$21,164. Such statistical analysis gives the court some indication of variance. The average or mean is less than the middle point in the series which, in turn, is less than the most frequently occurring value and as such, is more probable.

While there might be some argument to be made in relation to the mean or less compelling in relation to the median, it would seem that the mode, the most frequently occurring value, is the most likely value of the shares during the relevant period.

In the absence of any or any adequate evidence as to the date of the wrongful sale of the shares, the court cannot determine a unique valuation date. The court accordingly, determines a valuation based on the mode of the range of prices from the time of acquisition of the shares to the date of receivership as being the most equitable.

It is assumed that no anomalies will arise in relation to this approach to valuation. The court is conscious that a range with few prices may not be as statistically significant as a range of many prices.

The court will hear counsel in respect of how this might be implemented and will grant liberty to apply.