Case No: CL-2015-000087
Neutral Citation Number: [2017] EWHC 2104 (Comm)
IN THE HIGH COURT OF JUSTICE
ADMIRALTY AND COMMERCIAL
COMMERCIAL

Royal Courts of Justice, Rolls Building
Fetter Lane, London, EC4A 1NL

Date: 11/08/2017

Before :

THE HON. MR JUSTICE POPPLEWELL

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Between :

W NAGEL (A FIRM)	**Claimant**
- and -	
PLUCZENIK DIAMOND COMPANY NV	**Defendant**

- -
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Oliver Segal QC and Michael Jones (instructed by **DWF LLP**) for the **Claimant**
Robert Anderson QC and Peter Head (instructed by **Mishcon de Reya LLP**) for the **Defendant**

Hearing dates: 17 July, 2017; written submissions 26 July 2017

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Judgment

The Hon. Mr Justice Popplewell :

1. In the judgment I handed down following the trial ([2017] EWHC 1750 (Comm)) I determined amongst other things that the Claimant ("WN") had the benefit of a commission variation agreement that it would continue to be retained as DTC broker for the Defendant ("Pluczenik") for so long as Pluczenik held a Sight at De Beers, which Pluczenik breached by terminating the brokerage in August 2013. In assessing damages for this head of claim I left over for further argument the relevance and effect of taxation on the quantification of the amount to be awarded: see paragraphs [83] and [88]. At the handing down of the judgment I heard argument on the point, and the parties have subsequently made written submissions.

The basis of the assessment of damages

2. The evidence and argument at trial on the relevant quantum issues was directed to quantification of the claim under Regulation 17 of The Commercial Agents (Council Directive) Regulations 1993 ("the Regulations"), a claim which I rejected on the grounds that the Regulations did not apply. I accepted the submission of Mr Segal QC on behalf of WN that damages for the common law claim for breach of the commission variation agreement could be calculated in a similar way, but identified certain adjustments for the differences in approach required by the principles applicable to assessment in each case. In particular, I determined that damages fell to be assessed at the date of breach, that is to say in August 2013; and could be measured by taking an annual net profit stream which WN would derive from Pluczenik commissions on purchases at de Beers Sights, multiplied by a finite multiplier to reflect a number of factors including (a) the risk of termination for cause by either party or voluntarily by WN (b) the uncertainties as to the fact and extent of Pluczenic's continuing purchases of diamonds at De Beers Sights (viewed prospectively in August 2013) and (c) discount for accelerated payment. These contingencies were fully explored in both the factual and expert evidence at trial.

3. As to the profit stream, I determined that it should be based on the average commission from Sights over a three year period prior to termination, less the infrastructure and staff costs attributable to the Pluczenik brokerage over that period. The findings I made in relation to those matters required subsequent calculations by the experts, but the parties are now agreed that the effect of my findings is that the net annual profit stream so calculated is US$842,165 before tax. In their calculations both experts had assumed a corporation tax rate of 21% (because they were considering a notional corporate purchaser for the purposes of a claim quantified in accordance with Article 17 of the Regulations). Applying such a tax rate, the net annual profits after tax would be US$665,310.

4. In relation to the multiplier, WN's expert, Mr Paley, supported a multiplier of 6.6 to net profits after tax, deducting tax in his calculations at the 21% rate. Pluczenik's expert, Mr Pearson supported a multiplier of no more than 1 applied to EBITDA earnings, i.e a multiplier applied to earnings before tax. I determined

that the appropriate multiplier was 5 if to be applied to the net annual profits after tax (Judgment at [113]).

The rival submissions

5. Applying my multiplier of 5 to net annual profits after tax produces a figure of US$3,326,551. WN contends that that sum will be subject to tax in its hands when awarded, and accordingly should be grossed up so as to leave an equivalent sum in its hands after taxation of the judgment sum. The appropriate grossing up rate is said to be 21% because that is the rate Mr Paley applied to determine the net profits after tax as the multiplicand. Accordingly it should be multiplied by 1/0.79, resulting in an award of US$4,210,824 (to the nearest dollar). It is submitted that otherwise WN will suffer a tax burden twice, once in using a post tax multiplicand and secondly in suffering a tax liability on the awarded damages. The alternative route to the same result is to take the pre tax annual profit figure and multiply it by 5, leaving the resultant figure of US$4,210,824 to be taxed in WN's hands.

6. Pluczenik accepts that the earnings would have been taxable if received by WN as commissions, and that the judgment sum in the hands of WN as an award of damages is in this respect likely to be taxed at the same rate. Strictly speaking, the tax treatment of WN's earnings in the years following August 2013 if they had been (or would hereafter be) received as commissions is not necessarily the same as the tax treatment of an award in WN's hands in 2017. Since the two different exercises are concerned with taxation at different points of time, there is room for different tax liabilities by reference to changes in individual and corporate tax rates (taxation arises or would have arisen separately for the two partners in WN, one of whom is a company and the other of whom is an individual), as well as the changing position of the partners' tax affairs including other earnings and tax losses which might be offset. Nevertheless Pluczenik now accepts that in such circumstances the courts generally apply a pragmatic approach of not investigating such differences, and will award a sum reflecting the gross loss before taxation, leaving the judgment to be taxed in the claimant's hands under the taxation regimen applicable at the time of receipt, even if that may differ from the taxation which would have applied if received over a period of time as trading revenue: see ***Parsons v BNM Laboratories Ltd*** [1964] 1 QB 95 at 135. Pluczenik contends therefore that the relevant multiplicand is the pre tax figure of US$842,165, but that the multiplier should be 3.95, being an adjustment of the post tax multiplier by 21% to convert it to an equivalent pre tax multiplier. This gives the figure of US$3,326,551, which is what should be awarded. It is submitted that WN's approach is flawed because it involves applying a post tax multiplier to pre tax profits, which would be illogical and would overcompensate WN.

Analysis and conclusions

7. In principle the multiplier should be applied to the pre tax profit, leaving the judgment sum to be taxed in WN's hands. The crux of the dispute is whether there should be an adjustment to the multiplier of 5, which was expressed to be a post tax multiplier, now that it is to be applied to pre tax profits. The answer lies in the background to my determination of the appropriate multiplier.

8. As already explained, Mr Paley, WN's expert, sought to apply a multiplier to post tax profits, whilst Mr Pearson, Pluczenik's expert sought to apply a multiplier to the EBITDA pre tax earnings. Each took as their starting point the Small and Medium Enterprises valuation index published by the UK200 Group. This gives different figures depending on whether a price/earnings ("P/E") multiple is used or an EBITDA multiple. The experts agreed that a P/E multiple is conventionally applied when maintainable earnings are assessed by reference to profit after tax, whereas an EBITDA multiple is applied when maintainable earnings are assessed by reference to EBITDA, i.e. earnings before tax. Unsurprisingly the latter are lower than the former. Both experts agreed that the relevant average to be taken from the SME index as a starting point was 6.6 as a mean P/E multiple, and 4.8 as a mean EBITDA multiple (or 4.0 as a median EBITDA multiple). These reflect the same approach to the contingencies a buyer would take into account when applying a multiplier to the earnings of a company it is purchasing. Both experts agreed that either figure was appropriate, provided applied to the appropriate earnings i.e post tax profits for the P/E multiple and pre tax earnings for the EBITDA multiple.

9. The evidence and submissions focussed on the contingencies which might increase or decrease those figures. In reaching my determination that the appropriate multiplier was 5 *after tax*, I was using Mr Paley's P/E multiplier starting point of 6.6 and adjusting downwards for the contingencies which I regarded as appropriate. Had I been seeking to determine a multiplier which was applicable to pre tax profits, I would have used the lower EBITDA multiple as a starting point, which would have reflected exactly the same contingencies as were inherent in a P/E multiplier applicable to post tax profits. This is apparent from my findings in paragraph 112 that Mr Paley's multiplier was too high. Mr Paley's P/E multiplier of 6.6 was equivalent to a mean EBITDA multiplier of 4.8, which would have fallen to be reduced to take account of the factors identified in paragraph 112. It would therefore have been less than 5.

10. Although these starting points and adjustments were for multipliers applicable in the event of a notional purchase, as required for quantification of a claim under Article 17 of the Regulations, they also reflected the contingencies which were relevant in quantifying the loss to WN arising from the unlawful termination of the commission variation agreement.

11. Accordingly Pluczenik is correct in its contention that if those contingencies are properly to be reflected, a multiplier applied to pre tax earnings must be a different and adjusted figure from the multiplier which I deemed to be appropriate if applied to post tax earnings. Since the difference between pre and post tax profits was in this case reflected in the 21% corporation tax rate applied, it is appropriate to take a pre tax multiplier which adjusts my post tax multiplier of 5 to the same extent. Accordingly the award of damages, which is unadjusted for the fact that the commissions net of expenses would have been taxed as trading profits in WN's hands, is to be calculated by taking a pre tax multiplicand of US$842,165 and a multiplier of 3.95 (5 x 0.79).

12. The judgment sum (before interest) for this head of damage will therefore be US$3,326,551.