16th National Family Law Conference
Sydney October 2014

The Financial Issues Hot-House
Family Law Valuation, Tax and Other Cases
the interesting ones anyway…

Suzanne Delbridge and Scott Wedgwood

Introduction

This paper is the result of collaboration between a forensic accountant and a family lawyer. It is designed to demonstrate the development of the Family Court's approach to valuation methodology and also highlight recent cases concerning valuation methodology, tax issues and other matters pertaining to property settlement, in order to assist practitioners in their everyday application of the law.

The cases analysed fall within the following topic areas, which overlap in various instances, as would be expected:

Topic | **Page**

1. Premise and / or method of valuation
- Spencer v The Commonwealth (1907) 5 CLR 418 — 2
- Hull v Hull (1983) FLC 91-360 — 2
- Mallet v Mallet (1984) 156 CLR 605 — 3
- Reynolds v Reynolds (1985) FLC 91-632 — 4
- Elsey v Elsey (1997) FLC 92-727 — 5
- Ledarn v Ledarn (2013) FamCA 858 — 5

2. Minority interest (and value to the owner)
- Sapir v Sapir (No 2) (1989) FLC 92-047 — 6
- Turnbull v Turnbull (1991) FLC 92-258 — 7
- Mourd v Mourd (1991 - unreported) — 8
- Moylan v Moylan (1992 - unreported) — 8
- Georgeson v Georgeson (1995) FLC 92-618 — 9
- Harrison v Harrison (1996) FLC 92-682 — 10
- Ramsay v Ramsay (1997) FLC 92-742 — 10
- Eaton v Eaton (2013) Fam CAFC 106 — 12

3. Personal goodwill
- Wall v Wall (Unreported) EA 83 of 1999 — 13
- Goddard & Patterson (2011) Fam CAFC 14 — 15

4. Professional practices
- Best and Best (1993) FLC 92 418 — 15
- B&B (No 2) (2000) 26 FLR 437 — 15
- Hegarty (Unreported) SY 3496 of 2002 — 16

5. Highest and best use
- GWR v VAR Appeal SA 23 of 2005 — 17
- Nettler v Nettler (2009) Fam CAFC 185 — 18

6. Taxation
- Carruthers v Carruthers (1996) FLC 92-707 — 18
- Rosati v Rosati (1998) Fam CA 38 — 19
- JEL V DDF (2001) FLC 93-075 — 20
- Jarrott v Jarrott (2012) FamCAFC 29 — 21
- Lovine v Connor & Anor (2012) FamCAFC 168 — 22

Other bits and pieces

7. GFC Cases (and other hard luck stories)

- Myerson v Myerson UK Court of Appeal (2009) EWCA Civ 282 22
- Walkden v Walkden UK Court of Appeal (2009) EWCA Civ 627 23
- Greenwood v Greenwood (2009) Fam CA 787 24

8. Hindsight in business valuation

- Pope v Pope (2012) FamCA 204 25

9. Employee stock options

- Hurst v Webber (2009) Fam CAFC 137 26
- Nielson v Nielson (2012) FamCA 70 26

10. Relevance of an indicative offer

- Pitt v Pitt (2011) Fam CA 172 27

11. Valuing liabilities

- O'Connell's Case (1996 unreported) 27

12. Trust attribution to beneficiaries

- AC and ORS & VC and Anor (2013) Fam CAFC 60 28

13. Obligation not to make use of documents

- Harman v Secretary of State for the Home Department (1983) 1 AC 280 29
- Hearne v Street (2008) 235 CLR 125 29
- Commissioner of Taxation v Darling & Anor (2014) FamCAFC 59 30

14. Section 81 and the clean break

- Jong & Yeng (2014) FamCAFC 156 32

1. Premise and / or method of valuation

A review of valuation cases must start with ***Spencer v The Commonwealth***, so that we can put into context the move from "market value" and its replacement with "Value to the Owner" ("VTO") by the Family Court.

***Spencer v The Commonwealth of Australia** (1907) 5 CLR 418*

The Commonwealth had compulsorily acquired six acres of vacant land in North Fremantle, Western Australia, from Mr Spencer, which it intended to use as a fort. Mr Spencer argued that the land was worth more than he was paid, as it could be used for a factory.

This important decision established the ordinary meaning of "market value", with Griffith CJ stating:

> *"… the test of value of land is to be determined, not by inquiring what price a man desiring to sell could have obtained for it on a given day, i.e. whether there was, in fact, on that day a willing buyer, but by inquiring: "What would a man desiring to buy the land have had to pay for it on that day to a vendor willing to sell it for a fair price but not desirous to sell?"*

This concept of market value is known as the "*hypothetical willing but not anxious purchaser and vendor*" principle. The appropriateness of the application of this principle appears to have been first questioned by the Family Court in the matter of ***Hull v Hull*** and shortly thereafter in ***Reynolds v Reynolds***, as discussed below.

***Hull v Hull** (1983) FLC 91-360*

This case questioned the application of the "*hypothetical purchaser/vendor"* principle in the situation where a party held a minority interest in a family company.

The husband had submitted that the value of the wife's minority shareholding should be determined on a net asset backing basis (amounting to $267,000) while counsel for the wife submitted that the valuation should be determined on a capitalisation of future earnings basis, by which the value of the shares would be $Nil. The company had accumulated income tax losses, which were applied against all income derived, resulting in the company deriving $Nil taxable income.

The subject company, "Jell Property Co. Pty Limited" owned a block of units in Newcastle, NSW. The share structure of Jell Property Co. Pty Limited consisted of "A", "B" and "C" class shares. The "A" class shares provided full voting rights in the company, with these shares being held by the wife's mother. The wife held all the "B" and "C" class shares, which held no voting rights and provided a right to capital only.

Nygh J. concluded that it was artificial to value the wife's share in the private company in matrimonial proceedings according to the "*hypothetical purchaser/vendor"* principle laid down in ***Spencer v The Commonwealth***. This principle can only be applied where there is a ready and available market. Where there is a closely held family corporation with restriction on transfer of shares the Court must value the shares on the realistic value they have to the parties, not their commercial value or their value to a hypothetical purchaser.

This position was confirmed in the same Judge's decision in ***Bowman and Bowman*** *(1984) FLC 91-574.*

Nygh J. found that the wife held an asset with a value of approximately $267,000, however he noted that the asset was not realisable by her in the foreseeable future, and accordingly only took the asset into account in respect of consideration of the wife's future needs.

Mallet v Mallet *(1984) 156 CLR 605*

From a valuation perspective, the key issue in this case was the determination of the most appropriate method of estimating the value of the shares in a proprietary company. The initial trial was preceded over by Bell J. and was subsequently appealed to the Full Court of the Family Court of Australia. The Full Court judgment was then appealed to the High Court of Australia, with the High Court allowing the appeal and setting aside the judgment of the Full Court to restore the orders made by Bell J. As detailed below, the value of the shares determined by the trial Judge was upheld by the Full Court, and this issue was not appealed to the High Court.

The subject company, Mallet Holdings Pty Limited, along with its subsidiary companies, was engaged in a variety of activities, including investment in capital assets.

There were 100 ordinary shares in the company, of which the husband and wife each held 26 shares. The remaining shares were held in trust by the husband, for the benefit of the parties' three children, with each child beneficially entitled to 16 shares.

Three expert witnesses were called to give evidence of the value of the shares, with the wife's two experts valuing the shares on the basis of the net asset backing method. These valuations were rejected by the trial Judge, Bell J, with this rejection accepted by the Full Court. The valuer for the husband valued the shares in the company by adopting the capitalisation of future maintainable earnings methodology. This method was accepted by Bell J. although the capitalisation rate of 20% adopted by the valuer was amended to 5% due to the trial Judge's opinion that the valuer had, in the words of Mason J., "*failed to give sufficient emphasis to the asset backing of the ordinary shares, placing too low a valuation on the assets of the Company, and had given too much emphasis to the restrictions on transfer in the articles of association, ignoring the fact that the husband would as a result of the proceedings obtain 52 per cent of the ordinary capital of the Company.*"

It is noted that this valuation, based on a capitalisation of future maintainable profits, resulted in a value of $334,600, which was substantially less than the net assets backing of the shares (stated to be within the range of $560,000 to $700,000).

In the judgment of the High Court, Mason J. states the following:

24. "What is the most appropriate method of estimating the value of shares in a proprietary company depends upon a variety of factors. They include the purpose for which the valuation is made, the nature of the shareholding, the character of the company's business, its capacity to earn profits and the net value of its assets.

It has been said that a valuation based on earning capacity is generally most appropriate because the hypothetical purchaser of shares in a company which is a going concern is looking, not to a winding up, but to the profits which will ensue from the company continuing to trade (McCathie v. Federal Commissioner of Taxation [1994 HCA 9]; (1944) 69 CLR 1; Abrahams v. Federal Commissioner of Taxation [1994 HCA 32; (1944) 70 CLR 23; Commissioner of Succession Duties (S.A.) v. Executor Trustee and Agency Co. of South Australia Ltd. [1947 HCA 10; (1947) 74 CLR 358, at pp 361-362).

But it has been recognised that valuation by reference to assets backing or a liquidation basis will be appropriate where earning capacity provides no real measure of the true share value (The Commissioner of Stamp Duties (N.S.W.) v. Pearse [1951] HCA 43; (1951) 84 CLR 490) or presents overwhelming difficulties (Elder's Trustee and Executor Co. Ltd. v. Federal Commissioner of Taxation [1951] HCA 65; (1951) 96 CLR 563; Jekyll v. Commissioner of Stamp Duties (Q.) [1962 HCA 9; (1962) 106 CLR 353) or where the shareholding is such as to enable the holder to bring about liquidation of the company (New Zealand Insurance Co. Ltd. v. Commissioner of Inland Revenue (1956) NZLR 501). See generally the judgment of Gibbs J. in Gregory v. Federal Commissioner of Taxation [1971] HCA 2; (1971) 123 CLR 547."

This commentary establishes that there is no fixed rule as to the proper method for the valuation of shares or other property in the Family Court and that determination of the most appropriate method of estimating the value of shares in a proprietary company depends on a variety of factors.

***Reynolds v Reynolds** (1985) FLC 91-632*

As in ***Hull v Hull***, this case questioned the application of the "*hypothetical purchaser/vendor"* principle in the situation where a party held a minority interest in a family company.

The asset pool in this case included the interest held by the husband in a company, "Reynolds Wimbledon Pty Ltd", and a family partnership. The company principally held farming land which had been transferred to the company from the husband's father and the partnership farmed the company's land free of rent. It is stated in the judgment that "*both the company and partnerships were shams and were under the control of the husband's parents*."

Notwithstanding the fact that the share structure of the company in this matter was changed after the commencement of the proceedings, the original shareholdings in Reynolds Wimbledon Pty Ltd were as follows:

- 1 "A" class governing director's share held by the husband's father;
- 1 "B" class succeeding governing director's share held by the husband's mother; and
- 1 "C" class further succeeding governing director's share, plus 20,000 ordinary shares, held by the husband

The husband would only gain control of the company on the passing of both his parents.

Under the "*hypothetical purchaser/vendor"* principle it may be argued that a third party would not purchase shares in a company controlled by two other parties (the husband's parents in this case) and accordingly there was no market for the shares. By this reasoning it follows that there is no realisable value for the minority shareholding held by the husband.

However, the Full Court upheld the finding of the trial Judge in this case, being that the potential future value to the husband must be taken into account under section 75(2)(o) as it is a "*fact or circumstance which .... the justice of the case requires to be taken into account*".

The Full Court stated:

> *"We are doubtful, however, whether valuation methods which have been developed for commercial purposes are entirely appropriate for the purposes of family law. The present commercial capital value of shares in a proprietary company may not reflect their value to the spouse who either has control after divorce or who stands ultimately to benefit from them or control them after the death of generous parents, as appears to be the case here."*

Elsey v Elsey *(1997) FLC 92-727*

The subject company in this case was "Vales Point Crane Services Pty Limited", which operated a business and owned three cranes. The husband and wife were the directors and shareholders of the company, with the husband working in the business.

The trial Judge, Renaud J., valued the husband's business at $129,000 based upon the net tangible assets of the business, without consideration of a future maintainable earnings valuation basis.

On appeal it was found that the expert in this case had adopted the wrong valuation method. The valuer had clearly stated in his report that it is generally accepted that the capitalisation of future maintainable earnings is the appropriate valuation methodology to adopt where a business continues to trade, unless there is strong evidence that the business will not continue to trade in the future. The valuer's report also stated that the net tangible asset methodology is preferred where the entity is an investor and does not carry on trading operations. However, in his report the valuer had adopted a net tangible asset valuation basis only.

Baker J. found that the trial Judge had erred "*in adopting a valuation in which the methodology was fundamentally flawed*" and that this error, in conjunction with others, required a retrial of the case.

Ledarn v Ledarn *(2013) FamCA 858*

This case questioned the use of the "*hypothetical purchaser/vendor"* test where the party wished to continue running the business and had stated at the outset that the business was worth more to her than the valuation amount arrived at by an agreed valuation.

The business in this case was a family business which both the husband and wife had set up and developed together. The business, which manufactured motor vehicle accessories, had become very successful over the course of the relationship and both parties wanted to retain it in the property settlement. The court was required to decide which party should keep the business and also the value of that business.

The wife had been the manager of the business and the husband had designed the "unique product" that it manufactured. In 2003 the husband had entered into bankruptcy (to defeat a claim by the ATO it would seem) and as a result, the structure of the business had been changed to give much of the control of the business to the wife.

Despite an agreed valuation of the company at $8 million, the wife's case was that the business was worth $10 million to her, and she proposed that she receive it at that value. The husband argued that this was tantamount to "bargaining" with the court and that the wife should not be able to do that.

The court (Cronin J) accepted that there was obiter dicta to support the husband's view. However, it maintained that there was no reason why it could not attribute a value to the owner which was higher than the agreed value. The court asserted that the value to be applied was essentially a matter for the trial judge, which should be informed by the evidence and, in this regard, emphasised the importance that the value be just and equitable to both parties.

Therefore, while the court agreed with the husband that the wife was likely bargaining or trying to make her position more attractive to the court by offering the value of $10 million, it considered that it was important to examine how the value of something such as this would affect the just and equitable outcome, before making a decision.

The court held that, while normally the primary test is of the hypothetical prudent purchaser, in family law cases the commercial or capital value of the shares in a company often does not reflect the value for the spouse that controls them. It was necessary for the court to satisfy itself that the application of the principles would result in an appropriate value.

In this case the hypothetical purchaser method was not suitable because it was not the wife's intention to sell the business and she clearly indicated that the business was worth much more to her than the hypothetical value ascribed by the valuers. The court further noted that the "offer" of assigning a value of $10 million to the business would have had the effect of making more money available to the husband if the wife was to retain the business.

The court concluded that the wife should retain the business, stressing that this was because it was just and equitable to do so and not because she was the highest bidder. The court determined that in coming to this conclusion, it was appropriate to adopt the value the wife ascribed to the business as the proper value, being $10 million.

2. Minority interests (and value to the owner)

While minority interests have featured already in the premise of valuation cases set out above, the late eighties and early nineties saw a run of cases where the subject interests were held in closely controlled family entities. The relevance from a valuation perspective is both the method of valuation and the implied discount off the full pro rata value that was considered appropriate by the Court.

Sapir v Sapir (No. 2) *(1989) FLC 92-047*

In this Supreme Court of New South Wales case, the principal dispute related to the appropriate minority discount that was to be applied to a minority shareholding. Young J. agreed with the statements made in ***Reynolds*** and ***Hull***, concluding that the value of the wife's shareholding in a family company was the value of the shares to the wife, not their commercial value or their value to a hypothetical purchaser, and explained how this premise affected the selection of an appropriate discount rate.

In this situation, the wife held a 48% interest in three family companies which had been established by her parents. The rights attached to the classes of shares held by the wife were subordinate to the shares held by her parents, who had successive governing shareholder rights.

The husband's accountant and wife's valuer had calculated the value of the interests held by the wife, before consideration of any minority discount, at a similar value. However, the accountant for the husband had adopted a discount rate of between 4 and 6%, whilst the wife's valuer considered that a rate of between 12 and 16% was appropriate. The discount rate in each case was said to reflect the fact that the wife was a minority shareholder and, accordingly, she, or any purchaser from her, would have difficulty in realising the capital value of her shares, or being able to resell them at their full asset backing value, whilst her parents were alive.

It was noted by Young J. that the wife's father was in ill health, and that his will would leave his whole estate to his wife, should she survive him by 30 days, or otherwise the whole estate would be left to the wife in this matter, as she was the sole child. Similarly, the will of the wife's mother, left her whole estate to her husband, on the same conditions, or otherwise the wife. Young J. found that provided the wife outlived both parents, it was likely that she would inherit her parents' interests in the company.

Young J. opined that the accountants were valuing two different things. He adopted the basis of valuation propounded by the husband's valuer, stating the following:

> *"Essentially the accountants valued two different things. The husband's accountant has valued what is the value of the shares to the wife. His basic philosophy was that the only foreseeable purchaser of the wife's shares would be her parents and they would not be worried about the fact that they were buying a minority holding. Accordingly, a reasonable person in the position of the wife would accept a small discount on the asset value of the shares so as to have cash now, but there would be a figure below which she would not go but she would rather wait for her parents to pass on rather than part with the shares now.*

The wife's accountant valued the shares on what they would be worth to an independent third party. Such a person would discount the asset backing value heavily because of the difficulty in either realising his investment by winding up the company or alternatively, on selling the shares to some other third party who would have similar problems."

Young J. ultimately adopted a discount rate of 6.5% to represent the value of the shares to the wife. This rate was applied to the wife's proportional interest in the net asset value of the company, compounded over the lifetime of the controlling family member (10.89 years), to arrive at the present value of her shareholding. This effectively equated to a 50% discount on the proportional net asset value.

Turnbull v Turnbull *(1991) FLC 92-258*

The key aspect of this case concerned two family companies known as "Bald Hills Pty Limited" and "Allans Water Pty Limited" and the interest held by the husband in these companies.

The husband's father was the governing director of Bald Hills Pty Limited, with the husband's parents each holding one 6% non-cumulative preference share in the company. The remaining share capital consisted of 10,000 shares ranging from classes "A" to "H". The husband held 2,000 "E" class shares while the remaining shares were divided equally by the husband's four sisters.

The husband's father was also the governing director of Allans Water Pty Limited, with the husband's parents each holding one 6% non-cumulative preference share in the company. The initial remaining share capital was held solely by the husband (1,000 "A" class and 1,000 "B" class shares). Certain changes to the share capital were made in 1988 however the changes were determined by Baker J. to be a sham, and were accordingly set aside.

In this matter, the husband's parents conducted a grazing enterprise on a property that had been in the Turnbull family for several generations and was known as "Bald Hill" in Ebor, NSW, and on adjoining properties, with the husband working full-time on the properties. The Bald Hill property was owned by Allans Water Pty Limited.

In determining the value of the husband's shares the appeal Court was in agreement with the approach taken by Baker J. who agreed with the comments made in ***Reynolds, Hull*** and ***Sapir*** and went on to say:

"It is not appropriate in the context of Family Law proceedings to value shares in private family companies on the basis of what a hypothetical purchaser may pay for them. Similarly it is quite inappropriate to adopt the approach taken in the revenue and resumption cases."

"I am satisfied therefore in the context of proceedings under the Family Law Act that when a judge is determining the value of shares held by a party in a family company, he must look at the reality of the situation and value the shares on the basis of their worth to the shareholder. Turning to the facts of the present case, the husband's shares can only be valued, in my view, on the basis of their worth to the husband in the context of the Turnbull family as a whole."

Baker J. concluded that it was appropriate to apply a "modest" discount rate to the value of the interest held by the husband in each company. A discount rate of 5% was applied to the husband's interest in Allans Water Pty Limited, on the basis that the evidence advocated that it was ultimately the husband's father's intention for the Bald Hills property to remain in the husband's ownership (as he was the "family heir"). A discount rate of 10% was applied to the husband's one-fifth interest in Bald Hills Pty Limited in view of the interests of the husband's four sisters in the company.

Mourd v Mourd *(unreported decision delivered 29/11/1991)*

In analysing this case we have referred to the family entities that are relevant in respect of the determination of an appropriate minority discount.

The first company, "Kythera Pty Ltd", was incorporated in 1963 and was controlled by the wife's parents until their deaths. According to the facts set out in the judgment, on the death of her mother, the control of the company vested in the wife and her brother.

Additionally, the wife held 5,000 "D" class shares in the company, out of a total 40,000 shares. The wife is specified to hold a 12.5% interest in the company, and it is noted that her shareholding carries no voting rights, with rights to dividends only.

This company operated the Kythera Motel with the wife employed as manageress of the motel.

In 1990 "Pothety Pty Ltd" was incorporated, with the wife and her brother equal shareholders and directors of the company. The company was the trustee of the "Pothety Gerakiteys Family Trust", a discretionary trust created by deed in 1981, whose beneficiaries included the wife, her husband and other family members. The wife was the current Appointor of the trust.

Also in 1990, the "Atlantis Property Syndicate" was established, with the significant asset owned by this venture being an interest in the Natwest Building in Canberra, ACT. Kythera Pty Ltd held a 41.43% share in this entity, with the Pothety Gerakiteys Family Trust holding a 16.66% share. The remaining 41.91% interest in the syndicate was held by third parties.

The key area of disagreement between the experts for the wife and the husband related to the value of Kythera Pty Ltd. Both experts valued the company on the basis of a net asset backing valuation methodology, with one difference relating to the value of the Natwest Property owned by the Atlantis Property Syndicate. This issue is not considered in this paper. The remaining differences related to whether a discount of the interest held by the company in the syndicate was appropriate, and the appropriate minority interest discount to apply to the 12.5% interest held by wife in the company.

In respect of the interest held by the company in the syndicate the valuer for the wife adopted a discount of 15%. This discount was determined by reference to the syndicate agreement, which stated that prior to 30 June 1995 any sales of interests in the syndicate required a special majority.

Coleman J. conceded that this clause meant that the company "*would be to a considerable extent at the mercy of the other shareholders in APS in so far as the price obtainable for the disposal of that entity's share would be concerned.*" The expert for the husband did not apply a discount. She had assumed, on the basis of the family group's history of purchasing property and holding it for resale, the more likely course for disposal of the shares would result from the sale of the building. In the opinion of Coleman J. this did not have enough regard to the commercial realities explained by Mr G and ignored the significant third party interests in the syndicate. On the basis that no other discount rate was proposed and in light of his opinion that a discount was necessary, the discount rate of 15% was adopted.

In terms of the applicable discount to the interest held by the wife in Kythera Pty Ltd, the expert for the wife applied a 50% discount, on the basis of seven reasons (not specified in the judgment) One reason related to the sale of the wife's sister's shares in 1989 which suggested a 50% discount in value on the basis of a "directors' valuation" of the company.

The expert for the husband applied a 20% discount, stating in her report "*I would normally apply a discount factor of 15% to 20%"* and provided oral evidence in respect of this discount rate, which was not found compelling by the Judge. Ultimately Coleman J. preferred the evidence of the wife's expert and applied a 50% discount to the interest held by the wife in the company.

Moylan v Moylan *(unreported decision delivered 12/11/1992)*

The key company in question in this case was "Moylan Holdings Pty Limited" which was incorporated in 1970. The husband's parents had control of the company holding 80% of the voting rights. The husband held 4% of the voting rights and 10% of the shares pertaining to the right to dividends. The activities of this company were confined to investment.

It is also noted that there were a number of companies in the family group, including a company operating a civil engineering business and another company operating a construction company. The husband was a qualified civil engineer who has worked in the family companies since university and is the only sibling of the family who was involved in the day to day operations of the group.

The Judge noted that although the husband's parents had the ability to effectively control the company, the manner in which they had incorporated the family companies, allocated shares in these companies to family members and the general method of operation and management of the companies advocated that it was their intention to benefit their children, either upon their death or at a point when they had no interest in managing the affairs of the companies.

The Judge was satisfied that the husband would, at the very least, have a close involvement in the affairs of the family group of entities in the future and that it was very likely that he would take over the role of his father, once his father retired or had no further interest in the management of the company. Further, it was likely that it would be endeavoured to impress upon the other siblings that the husband's continued operation of the family business would be of benefit to all the family members.

To allow for the uncertainty as to when the husband's parents would cease to be involved in the effective management of the company, and that the husband would need agreement from his siblings in respect of the future of the family business, the Judge found that a discount of 20% off the value of the husband's interest in the company was appropriate.

Georgeson v Georgeson *(1995) FLC 92-618*

"M. G. Voyage Investments Pty Limited" was incorporated in 1964. The wife's parents and her sister were the directors of the company, with her father holding one "A" class redeemable preference share, her mother holding one "B" class redeemable preference share and her sister holding one "C" class redeemable preference share. The ordinary shares of the company were equally and beneficially held by the wife and her three sisters.

The company was principally involved in investment in real estate. The wife worked in a clerical capacity on a part-time basis in one of the family companies.

In this case both valuers agreed that the appropriate valuation method to adopt was the net asset backing approach but differed in their application and quantification of the appropriate discount rate. The wife's valuer applied a compounded discount rate of 5%, being the rate which an investor could expect to obtain by investing in other investments with a comparable risk, over 22 years, being the remaining life expectancy of the controlling family member, to arrive at the present value of the wife's shareholding. It is noted that this method effectively equates to a flat discount of 66% of the value of the net assets. Conversely the husband's valuer applied a flat 15% discount rate.

The wife's expert applied a discount to the current nominal value of the pro rata interest in the company, as opposed to applying a discount to the forecast value that the shares may have in the future when the wife prima facie has access to the value. The present value of an asset that will inflate over a certain period is its nominal value today, i.e. discounting a forecast value to present value should result in the nominal value if assumptions to risk and return are consistent.

The Judge accepted the approach of the wife's valuer noting that the wife, while an employee of the company, had never been in any position of management nor was there any evidence that she was likely to and that the wife's continued involvement in the company *"is not essential for the good of the shareholders"*. It was noted that the wife had the benefit of dividends and a loan account but she had no control to influence whether dividends or interest were paid. In the past four years no dividends had been declared by the company, nor was there any obligation to pay dividends in the future. Further, control of the company was expected to be directed to the wife's younger sister, in which case the wife may not be able to access the full value of her shareholding even on her parent's demise.

The Judge accepted the valuation of the wife's expert as including the risk, lack of negotiability and lack of control inherent in the wife's minority interest. This decision was appealed by the husband however the Full Court held that it was open to O'Ryan J. to rely on the submissions provided and that the trial Judge had accepted expert evidence that the method selected was appropriate in the circumstances of the case. The full Court noted that:

> *"Further, neither counsel could refer us to any authority to support the submission that the discount rate should be applied to the value of the assets at the expiration of 22 years rather than to the present value of those assets. In addition, it was not put to Mr Broadfoot* [the wife's expert] *in cross-examination that his methodology was flawed in that he applied the discount to the present value of the assets rather than to the value in 22 years' time."*

Harrison v Harrison *(1996) FLC 92-682*

In this case the husband had been employed by the family construction company, "G J Harrison Pty Limited" for his working life and held a 14% interest in the company. He also held a minority interest in another family company, "Harfam Pty Limited".

The Full Court (Ellis, Baker and Warnick JJ) relied on ***Hull***, ***Turnbull***, ***Reynolds*** and ***Sapir***, concluding that the value of the shares held in a family company must be based upon the value of the shares to the shareholder.

The Full Court agreed with the trial Judge's interpretation of the law, including the following comments made by the trial Judge:

> *"The husband's submission was that although the shares can be artificially valued they are valueless because unrealisable. This ignores the benefits which accrue to the husband through their ownership. Amongst those benefits are the right to receive dividends, which in the past have been substantial, the buffer of a loan account, the provision of a motor car, yacht and trailer, the contribution towards payment of certain household bills and the flexibility of being, if not self-employed, employed by a company in which he is a shareholder and director and whose ethos allows him a degree of autonomy. It also effectively ignores the assets of and business conducted by the companies and the reality of the husband's interest in them. I am satisfied in the context of proceedings under the Family Law Act that when a judge is determining the value of shares held by a party in a family company, she or he must look at the reality of the situation and value the shares on the basis of their worth to the shareholder. In this case, the husband's shares can only be valued on the basis of their worth to him in the context of the Harrison family as a whole. That worth is substantial."*

The trial Judge adopted the net asset backing valuation methodology to value the interest held by the husband in the two companies. A minority interest discount of 10% was applied to the value of his shareholding in G J Harrison Pty Limited and a discount of 5% was applied to the value of his shareholding in Harfam Pty Limited.

Ramsay v Ramsay *(1997) FLC 92-742*

The case of ***Ramsay*** again considered the value of a minority shareholding in a closely held family company, as well as providing further guidance in respect of the application of the "value to owner" concept.

In this case, the interest in question was the value of the minority interest held by the husband in a family company, "Pindara Securities Pty Ltd". The 50,000 ordinary shares in the company were held equally by the husband, his father, his mother and his sister. In addition, there were 5,000 class "A" ordinary shares which were held by a related company, "Bergenia Pty Ltd", with this company being controlled by the husband's father and mother. Historically, dividends were paid by Pindara Securities Pty Ltd to Bergenia Pty Ltd, and then distributed to family trusts.

At the time of the proceedings Pindara Securities Pty Ltd owned substantial real estate and listed security investments. The company had previously held shares in another company that owned a private hospital, established by the husband's parents, and a sports and rehabilitation clinic, both located on the Gold Coast. The husband was a director of the hospital and manager of the sports clinic until the sale of the hospital in 1987 and closure of the clinic in 1993.

The expert for the wife valued the interest held by the husband on a net asset backing basis, with this approach ultimately rejected by the Judge. Warnick J. asserted that in determining the value of the shareholding the expert assumed that it was likely that the husband would control the company at some stage in the future. In his view this was not supported by the evidence in the case, and further, this assumption was not a matter for the valuer to conclude but rather a question for the Court (refer to point (e) below).

Warnick J.:

> (83999) *"I proffer the following observations:*
>
> *(a) a question to be answered in each case, and as to which expert evidence may be admissible, is whether there is a market for the shareholding;*
>
> *(b) if there is a market, evidence of the market value is highly likely to be relevant, even if there is no intention to sell;*
>
> *(c) it is however, unhelpful for valuations to focus on the lack of a market in establishing a value to the shareholder. Any allowance for lack of realisable value is best made by the Court, in all the circumstances of the case, particularly the presence or absence of other assets which are disposable;*
>
> *(d) in cases where there are no realisable assets, the lack of market value of the shareholding will usually be critical, not only to the "division" of property, but perhaps even more so, to the orders made;*
>
> *(e) if, on the facts of the case, there is any prospect of the minority shareholding party gaining control of the company, the question of the probabilities of that event is likely a question for the Court. If that is so, all that the valuers ought be concerned with is the value to the party if he/she gains control, as well of course as the value if the party remains a minority shareholder;*
>
> *(f) similarly, if there is any issue about them, questions of the probabilities of particular benefits being received by a shareholding party in the future, are likely best left to the Court, but again valuers ought assess the value of the shareholding, both on the basis that the benefit is received and that it is not."*

The expert for the husband valued the interest held by the husband primarily at $Nil, on the basis that there was no available purchaser for the shares. This methodology was rejected by the Judge. The expert had also applied an alternative basis of calculation, with the valuation based on the income stream historically derived by the husband from the company, including salary, fringe benefits and distributions. As noted by Warnick J. this was argued to represent a significant discount, of approximately 55%, on the net asset backing value of the shareholding.

Warnick J. ultimately accepted the alternative valuation, being a capitalisation of future earnings, providing the following commentary in his judgment in order to reduce confusion surrounding the "value to the owner" concept and the term "realistic" provided by the Court in prior judgments:

> "*The purpose of the valuation is to ascertain the value of the shares to the shareholding party, "... not their commercial value or their value to a hypothetical purchaser" (Baker J, Turnbull and Turnbull; Turnbull JR, Bald Hills Pty Ltd, Allan Waters Pty Ltd and Apropos Pty Ltd (Interveners) (1991) FLC ¶92-258 at p 78,738) (see also Sapir v Sapir (No 2) (1989) FLC ¶92-047 at p 77,543 -- decision of Young J, Supreme Court of New South Wales; and Harrison and Harrison (1996) FLC ¶92-682 at p 83,087).*
>
> *In a number of cases in which it was stated that the value to be ascertained was that to the shareholding party, it was also stated that the value must be "realistic", as if these terms are synonymous. If the use of the term "realistic" is seen as simply "shorthand" for the expression "value to the shareholder", then no doubt there is no inconsistency.*
>
> *It seems arguable however that what is "realistic" (literally taken) may not be the same as the value to the shareholder. The latter is often not the value that can be achieved on sale and also often takes account of a number of assumptions about the receipt of benefits (often not attaching to the shareholding "per se").*

Thus it has a strong "notional" aspect, in contrast to the reality of the market. It seems arguable that the concept of "realistic" value to the shareholder ought include a recognition of what can be achieved on sale. Alternatively, such recognition ought be granted some other place in the decision-making process.

It is in this area of tension, between what I suggest is realism and what might be assessed as the value to the shareholder, that the failure to identify factors pertinent to the valuation exercise being undertaken and in particular the failure to identify those factors, the import of which ought be left to the discretion of the Court, causes particular difficulty."

***Eaton v Eaton** (2013) Fam CAFC 106*

In this case, the husband owned shares in a company referred to as "P2 Company Pty Ltd". The company carried on a business that commenced in 1948 and was founded by three families, one of which was the Eaton family. Each of the three families continued to maintain their interest in the company. The business operated in Brisbane and employed approximately 10 staff, including the husband who was the general manager.

The issued share capital consisted of 7,403 ordinary shares. The husband held 3,392 ordinary shares representing 45.82% of the overall shareholding while a related family trust held 100 ordinary shares (1.35%), being a combined holding of 47.17%. There were nine other shareholders spread between the three family groups, including the husband's mother.

The company had three permanent directors, which each represented their respective family's interests.

The company was tightly regulated by its Articles of Association. One such provision was that any shareholding beyond 25% of the company's shares would not carry any voting rights. Accordingly, Jarrett FM opined that although a controlling interest may be possible, it appeared unlikely.

It was accordingly noted in the judgment that the husband could not exercise legal control over the other shareholders or the other directors. It was stated that the husband's shares effectively held 21% of the voting rights, and when combined with the shares held by the family trust, the total voting rights were 25.38%. This was insufficient to allow the husband to pass an ordinary resolution. Further, there was no suggestion in the evidence that the husband would be likely to become a majority shareholder or gain control of the board of directors in some other way. Jarrett FM accepted the husband's evidence that although he was the managing director and from time to time the directors acted upon his advice, at other times they did not.

The significant dispute between the respective experts for the parties was the value of the discount that should be applied to the husband's minority shareholding.

In this matter, the expert for the wife suggested that a discount within the range of 10% and 30% of the net asset based value of the shares would be appropriate.

The expert for the husband instead relied upon historical sales of shares in the company and concluded that a value of $187 per share was appropriate, which effectively reflected a 52.06% discount.

However, in respect to the historical sales Jarrett FM opined that there was no direct evidence regarding a market for these shares. The last three share sales had occurred in 2005, 2007 and 2009 and were to existing shareholders, with only 65% of the last share offering being sold and the remaining shares were still unsold at the date of the trial. Accordingly, Jarrett FM stated that the past sales demonstrated only that there was no market for the shares beyond the existing shareholders.

The factors which impacted the discount rate applied by Jarrett FM included the following:

a) that the husband did not, either directly or indirectly, hold a controlling number of shares;
b) that the husband's single or combined shareholding does not provide him with authority to pass an ordinary or special resolution;
c) that the husband has no authority to overrule any decisions of the other two directors relating to dividend declarations, share transfers, or any other matters;

d) the company is controlled by its three permanent directors who cannot be removed by an ordinary vote of shareholders. They cannot be removed even by a special resolution comprising 75% or more of the shares of members present or by proxy;

e) the board of directors cooperate in the making of resolutions with the company being run for the benefit of the three families and their descendants; and

f) that no dividends have been declared over the past three years and they have only been declared infrequently prior to that time.

On the basis of these factors Jarrett FM concluded that the higher end of the range of discount provided by the wife's expert, being 30%, was too little. In addition, he did not believe that the discount arrived at by the husband's expert was sound, as the expert misunderstood one of the provisions of the Articles of Association of the company. Jarrett FM ultimately concluded that an appropriate discount of the husband's minority interest was 35%, which was upheld on appeal to the Full Court.

3. Personal goodwill

Wall v Wall *EA83 of 1999 – Judgment 26/10/2000*

In this case the husband was a film producer and operated his own business through a company "Off The Wall Pictures Pty Ltd", of which he and his current de facto wife, Ms Lee, were the only and equal shareholders. It was claimed that business relied entirely on the skills of the husband and Ms Lee.

An appeal was made by the husband from orders made by the trial Judge, Cohen J. The key issue from a valuation viewpoint was the value applied to the business conducted by the husband (in particular the value ascribed to goodwill).

The trial Judge concluded that the value of the husband's 50% shareholding in the business was $55,043, and in determining the value of the company included an amount for goodwill of $102,000.

As set out at paragraph 32 of the Full Court judgment, the trial Judge rejected the argument advanced for the husband that, *"……because the business [of the company] relies wholly on the skills of the directors [the husband and Ms Lee], the goodwill is worth nothing and that, in reality, the business is merely a resource which is a manifestation of their earning capacity rather than property"* At paragraph 100 of the first instance judgment, his Honour said:

> *"The simple fact is that the husband and Ms Lee have chosen to operate the business through the medium of a company in which they own shares. The husband's share is property. It has to be valued. Its value is to be ascertained in the husband's hands. The goodwill is, in any event, a manifestation of only two years super profitability and not the income of the husband for the rest of his working life in it. The husband's earning capacity is quite a different thing from the value of the goodwill of the business. It is not double counting to rely on both the goodwill for the purpose of s.79 and the husband's earning capacity for the purpose of s.75 (2)."*

The husband challenged the trial Judge's valuation of his share under three elements. The first element related to the trial Judge's acceptance that the company had any goodwill to value. The second related to the finding that the husband's share had any value of significance *"in the husband's hand".* The third related to certain add backs that were made in determining maintainable super profit.

The Full Court judgment

The Full Court accepted the trial Judge's statement that the value to be ascertained in relation to the husband's share in the company is its value "in the husband's hands", with authority found in ***Turnbull***, ***Sapir*** and ***Harrison***. Furthermore, the Full Court found that it was open to the trial Judge to reject the submission that because the business relies wholly on the skills of the directors the goodwill is worth nothing, as follows:

67 "Such a proposition ignores the fact that "goodwill" in relation to a business may attach to such features as the business name or its location, and many small businesses, which rely entirely on the skills of their operators (e.g. Professional practices) are considered to have some goodwill. As Mr Bell said in his report [70] "….. an ordinary person prefers taking over an existing business, rather than setting up a new business". Certainly, an important aspect of that is the set up of an existing business, which would usually include its tangible assets, and possibly some intangible assets other than goodwill, but the mere fact that a business name and clientele who habitually resort to, is, or at least may be, an intangible asset (categorised as "goodwill") of some value. As Wayne Lonergan says [71]:-

> *"The reality is that goodwill exists because a business has a demonstrated capacity to earn cash flows exceeding the cash flow which one would normally expect if one were to invest the same level of tangible and identifiable intangible net assets in a similar business starting from scratch."*

However, the Full Court rejected the approach taken by the trial Judge in valuing the goodwill of the company at $102,000:

68. At the same time we think it was important for his Honour to recognise what is really adverted to in the evidence of Mr Bell, particularly the statement quoted in paragraph 62 hereof, and in his oral evidence quoted in paragraph 64 hereof, namely that there is a significant element of personal goodwill attaching to both the husband and Ms Lee in this case, which is clearly not transferable, and which, in the case of the husband at least, is ***really part of his earning capacity rather than property****.*

69. The difference between commercial and personal goodwill is described, thus, by Lonergan, with particular reference to the valuation of professional partnership partnerships:-

> *"The goodwill of professional practices may be attributable to the combined personal attributes of the partners which revolves around their skills, reputation and personal relations between each other and their clients. Alternatively it may reflect commercial goodwill which relates to their clients' favourable attitudes towards the practice as a whole.*
>
> *This favourable attitude may have been gained through the reputation of the firm or through prior connections and dealings with the firm.*
>
> *The value of commercial goodwill is reflected in the advantages that a prospective partner would obtain by entering into a practice with a recognisable name, established clientele, a range of services, research and precedent databases, well trained staff and recognised programmes and procedures. Personal goodwill attaches to the individual and is attached to that person's own ability, skills, experience, training and reputation. As a general rule personal goodwill is likely to be disproportionally higher than commercial goodwill in a sole practice or small specialist practice of say two or three partners whereas commercial goodwill is likely to be of more value in a larger practice trading under a well recognised name or national or international affiliation."*

70. With respect to his Honour, we think that in saying, as he did (in paragraph 100) that "the husband's earning capacity is quite a different thing from the value of the goodwill of the business", he failed to appreciate the important distinction between commercial goodwill and personal goodwill and failed to have regard to that evidence of Mr Bell to which we have referred in paragraph 68 hereof. In valuing the goodwill of the business as he did, we think that his Honour effectively treated the personal goodwill attaching to the husband as part of the commercial goodwill attaching to the business, and this resulted in the adoption of a grossly inflated value for the business, for the company and for the husband's share in the company.

In considering the second element of the appeal in relation to the value of the share in the company, and specifically, the value of the share in the hands of the husband, the Full Court said:

74. We think it was open to his Honour to find that the husband's share had <u>some</u> value in his hands because it conferred on him <u>some</u> benefits which he could not have obtained as a sole trader (e.g., the benefit of Ms Lee's input into the company of which she too was a shareholder, and the benefits flowing from the continued use of the company name and reputation, in the conduct of the business, rather than in his own or some other name which he might need to adopt and take time to attract clients to). However, we do not think that it was open to his Honour to place a value on that share in the husband's hands by simply capitalising the adjusted net profits of the business, adding the value of the net tangible assets, and dividing it by two because the husband was a 50% shareholder in the company. As we have said above, to do so involves attributing entirely to the business whatever personal goodwill attaches to the husband which, on any view, would be substantial in this case.

The appeal was allowed, relevant parts of the trial Judge's orders were set aside and directions were given for the filing of written submissions.

Therefore, while still having the objective of arriving at the "value to the party", the Full Court has made a clear distinction between the value of commercial goodwill and personal goodwill and earning capacity versus property.

In applying a value to the owner objective it is therefore necessary to carefully consider the appropriate methodology and also the origins of any resulting goodwill. A clear distinction needs to be made between personal and commercial goodwill together with an appropriate allocation of an income stream between property and financial resources. Where commercial goodwill exists and is appropriately valued using a super profit approach, care must be taken not to double count the profit cashflow as both property and a financial resource. The resource in these instances should be the notional salary allowed for the proprietor, not the profit from the business activity.

<u>***Goddard & Patterson** (2011) FamCAFC 14*</u>

In this case, the husband and wife were the directors and shareholders of a company named TD Pty Limited. The parties jointly instructed a single expert to undertake a valuation of said company. The single expert attributed a value of $459,000 to goodwill of the company.

The trial judge accepted that most of the goodwill centered on personal goodwill of the husband. The trial judge concluded *"that on the evidence it was extremely difficult to attribute a present value to the business apart from the separately accounted for assets."* In the circumstances, her Honour did not consider it was possible, but indicated she intended to return to this as a factor warranting consideration pursuant to s75(2).

Her Honour was satisfied that "*most of the goodwill centres on the personal goodwill of [the husband]. [The wife] made the point that [the husband] had considerable skill, experience and good relationships with his clients. This is evidenced by the gift of the [P] shares to him. He accepted he had good working relationships with the people he dealt with. As the single expert points out, these personal skills are not transferable. I have little trouble accepting that the business activities are dependent on [the husband] and that he is the creative focus of the practice. He works with his brother and they form a team. In the main the clients are gained through [the husband's] skill and reputation."*

The wife appealed the judgment on the basis that the trial Judge erred in finding that any commercial element of the goodwill is minimal despite the fact that the single expert had quantified the goodwill of the company to be $459,000.

The Full Court dismissed the appeal on the basis that her Honour was entitled to reach the conclusion made on the basis of the evidence before her, and thus no appealable error has been demonstrated.

4. Professional practices

The valuation of professional practices is considered in cases such as <u>***Best and Best** (1993) FLC 92 418*</u> and <u>***B&B (No 2)**(2000) 26 FLR 437*</u>. While the judgments in the reported cases focus predominantly on whether the subject partnership interest is property under section 79, they also contain discussion on the appropriate valuation methodology.

While a generally accepted approach to the valuation of a professional practice is the capitalisation of super profits (being those profits generated by the practice over and above a return to the principal for his effort in the practice and a return on his net investment in practice assets) there is a very different approach taken by the Court as to the acceptability of this approach in **Best and Best** (where it was applied) and the later decision in **B&B** (where it was rejected). The valuation methodology was not challenged on appeal in **Best** and therefore the Full Court made no comment as to the appropriateness of the method applied (see para 88 of **B&B**).

In **B&B**, the interest in the legal practice held by the husband was incapable of assignment and the practice was very clearly a "no goodwill" practice. On exit from the practice, the partners were entitled to their capital and current account balances and a share of work in progress increments. The valuer for the wife applied a capitalisation of super profits approach, and for various reasons as set out in the judgment, his valuation was not accepted by the Court. The valuer for the husband considered the value of the husband's current and capital accounts and also considered whether there was any value under a capitalised super profit approach.

Due to a large variance in the allowance for the salary of the husband ($250,000 v $750,000) the super profit valuation of each of the valuers was materially different. The valuer for the husband in fact found that the super profits earned by the husband were $Nil. Furthermore, the accountant stated that in the particular case the adoption of an approach of "value to a party" did not provide legitimate support for the application of a super profits methodology in determining the value of property represented by the husband's interest in the partnership. The accountant concluded that it was inappropriate to use the "value to the party" approach to support a super profit methodology because the interest was not assignable in the hands of the husband, any other partner, or any other person. The interest had no greater value in the husband's hands. The Court accepted this evidence.

The facts in **B&B** may distinguish it from other cases, in that the husband was at the top of his profession, regarded by his peers as "virtually irreplaceable", and the structure of the partnership was such that his interest could not be disposed of. The appropriateness or otherwise of the super profit approach became a moot point as the evidence of the preferred accountant was that there was no super profit. Interestingly, Moss J makes comment that the Full Court in **Best** "*decided nothing with respect to the valuation of that partnership interest*", because there was no challenge on appeal to the determination of the value by the trial judge. It was disappointing therefore that the issue became irrelevant in the context of **B&B**, as no further opinion was offered by the learned judge as to the appropriateness of the super profit approach.

It is our experience that the majority of professional practice valuations undertaken for Family Law purposes utilise the super profit approach, supported by the value to the owner objective. At risk is the potential double count of a professional's capacity to derive income, as both a capitalised value in the property pool and a future financial resource.

We have seen many valuations (legal, medical and accounting practices) where, in the interests of arriving at the "value to the owner", the super profit generated by the professional has been capitalised without regard to whether the resulting goodwill is personal to the professional or associated with the practice name, location, longevity of the practice, etc, in which case it may be commercial.

This issue of the character of the goodwill is not, in our opinion, considered with any degree of clarity in the cases already referred to.

Hegarty and Hegarty *(SY 3496 of 2002)*

At issue in the unreported case of Hegarty and Hegarty (SY 3496 of 2002), before Coleman J, was the valuation of the husband's accountancy practice. The practice was unusual in that the majority of the husband's clients were McDonald's franchisees. The issue of the appropriateness of applying a value to the owner approach was before the Court. While both accountants had applied a super profit approach in determining the value of the husband's practice, their calculation of super profit and the appropriate capitalisation rate were materially different. It was submitted for the wife that the husband's accountant had "*misunderstood his task for family law purposes*". At paragraph 40 of the judgment, Coleman J states:

> *"In support of that contention, a number of decisions and papers were referred to. The thrust of the submission of Counsel for the wife was accordingly that the value of the shares or interest is their worth to their owner or holder rather than "their commercial value or their value to a hypothetical purchaser" (Sapir v Sapir (No 2))."*

Coleman J ultimately adopted a mix of the evidence of both accountants, using the super profit as determined by the wife's valuer and the capitalisation multiple of the husband's valuer, applying a value to the owner objective per paragraph 50 as follows:

> *"Commercial concepts of valuation do not adapt readily, or necessarily realistically, to an interest such as that of the husband in Rolins. It must be remembered that the notion of value is ultimately linked to what might be paid or realised for an asset. The classic formulation of the test of valuation of the High Court in Spencer v Commonwealth (1907) 5 CLR 418 has no real application in a case such as the present where there is no suggestion that the husband will attempt to sell his interest in Rolins, or that, if he did so that it would necessarily be saleable, although it is reasonably apparent that there must be a figure at which a potential purchaser would be prepared to take the risk of retaining sufficient of the husband's current client base to justify paying a sum of money for the opportunity to do so and acquiring his interest in the tangible assets of the practice. Clearly, by having an established practice, a client base, and infrastructure which enables him, albeit only as a consequence of hard work and long hours to do so, an income stream, must be worth something to the husband. Not surprisingly, neither expert suggested anything analogous to the "comparable sales" upon which real estate valuation practice is so heavily reliant, and thereby generally reliable. Having regard to the authorities, it is difficult to reject the notion that, if only for want of a better approach, the value of the husband's interest in Rolins should be seen as the value of the interest to him, albeit that somewhat subjective exercise must be undertaken in the most objective way possible. The authorities leave little doubt that, however theoretical the value of an interest, the interest itself is "property" within Part VIII of the Act. It is, realistically, at the capitalisation stage that the factors which determine the real value of the entity to the husband assume critical significance. Even then, the "value" determined only becomes available to the husband if he sells his asset, and ceases to have the income which it produces, albeit he would retain the skills which enabled him to maintain the value of such interest prior to its sale."*

5. Highest and best use

These cases are relevant particularly where a rule of thumb valuation might yield a value higher than capitalised maintainable earnings, which is usually the case for real estate agencies, strata managers, mortgage brokers, financial planners and accountants.

GWR v VAR Appeal *SA 23 of 2005*

The wife was residing in the former matrimonial property of the parties. It is reported that for approximately $2,500, the property could be subdivided, with the subdivision already being approved. The property was valued at $270,000 if not subdivided, but the value increased to $375,000 if the property was subdivided. The wife had no intention to subdivide the property.

The trial judge concluded that it was "*appropriate to value the property as one lot and I therefore attribute a value to the B property of $270,000."*

The husband appealed the decision on the basis that $375,000 was the value of the property, whether in the hands of the wife or otherwise. Whether or not the wife chose to subdivide the property, now or in the future, was immaterial and subject to the payment of insignificant costs to formalise the subdivision. Adopting a value less than $375,000, was not to value the property on a "highest and best use valuation".

The husband's appeal was allowed and successful. As stated by the Full Court, *"the highest and best use" of the land at B was as two subdivided lots which was "legally possible…".*

Nettler & Nettler *(2009) FamCAFC 185*

The parties owned a mortgage broking business which they established in 1998, with the wife working in the business since it was established and the husband commencing employment in the business in 2000. The husband was dismissed in 2005, after the parties separated. The wife was the sole director of the company structure, with the parties holding all shares in the company.

The principal asset of the business was its "loan book", a catalogue of the mortgages settled by the business. In a mortgage business trailing commissions are received from each of these mortgages in the loan book, until the mortgage is discharged.

The expert for the wife valued the business on the basis of its future maintainable earnings, whilst the expert for the husband valued the business on the basis of the amount that would be received upon disposal of its assets, including its loan book. There was no dispute between the experts that the loan book could be sold for somewhere between $335,000 and $345,000.

The trial Judge, Coleman J, concluded that the value of the business was the sum of the value of the loan book and the other tangible assets. It was acknowledged that this value was greater than the valuation determined on the basis of the future maintainable earnings of the business.

The wife appealed this decision on the basis that it was "unrealistic" to value the loan book at $340,000 when she did not intend to sell the loan book but intended to continue operating the business, and relied on the loan book to derive income in her business.

The wife's appeal was dismissed by reference to the principle found in **Spencer v The Commonwealth**, as relied upon by Coleman J. It was noted that the **Spencer** principle had been applied to a wide range of assets, not just land. As stated by the Full Court: "*It cannot be right in principle that a party wishing to hold onto a business can then insist on the business being valued on its future maintainable earnings in circumstances where the business, or its underlying assets, could be sold immediately for a substantially greater sum. To conclude otherwise would be inconsistent with* ***Spencer****.* "

It was also acknowledged that in adopting the highest and best use approach, it is essential to consider the effect of any realisation costs and taxes that may be incurred, as well as the effect on the future earning potential of the parties pursuant to the negotiated terms of sale, in this case being *" ..the probable face of restraints on the ability of [the business] and/or the wife to compete with the purchaser of the loan book for a defined period within a defined but unspecified geographical location..."*

6. Taxation

Carruthers v Carruthers *(1996) FLC 92-707*

In this case, the husband sought to bring into account as a liability the capital gains tax and selling expenses on the notional disposal of various parcels of real property.

The approach was based on the husband's proposal that an Order should be made that the wife transfer a number properties to the husband and upon his proposition, it would be necessary to sell these properties in order to finance a new purchase that he was committed to make.

It was reported, that at the time of the trial, title for the husband's new purchase had not issued but was expected to issue in the near future.

In considering whether an allowance for tax and other realisation costs should be made, the trial judge considered the following:

1) *"…tax law is not a constant, and differing views have been taken in this country to rates and the incidence of capital gains tax from time to time. The longer the likelihood of a particular property being retained, then in my view the less it is justifiable to treat the property as being subject to a present notional liability.";*

2) *"… the person who holds the property may, over a period be able to so arrange his or her affairs as to heavily reduce, if not completely eliminate the liability…"; and*

3) *"…the extent of the liability will fluctuate with the market and as it is not a present liability, if the person who holds the property does not propose to realise it, the incidence of the tax might be quite different at the time of sale."*

Nicolson CJ concluded that "*the husband should be allowed a substantial proportion of these costs, but I do not think that he should have all of them and I propose therefore to allow him the realisation costs and capital gains tax effects in relation to the relevant properties other than Balfe Street"*

Accordingly, it has become a widely adopted practice to make an allowance for tax and other realisation costs where the asset is likely to be disposed of, or the Orders of the Court will cause a disposal.

Rosati v Rosati *(1998) FamCA 38*

The husband in this case was a real estate agent, operating a real estate agency, "LJ Hooker Crows Nest" through a trust known as the "LJ Hooker Trading Trust". The husband asserted that he was suffering mental health issues and accordingly wished to sell his business and find alternative employment, but the trial Judge opined that the husband's health problem did not necessitate that course of action occurring.

Accordingly, the trial Judge considered that it was "*appropriate to take into account his capacity to continue to carry on business at the present for the purpose of these proceedings*". However, he also took into account the fact that if the business were to be sold, the husband could be liable for capital gains tax with the amount of tax dependent upon factors including the timing of the sale and the sale price.

The decision of the Full Court in ***Rosati v Rosati*** (1998) FamCA 38 affirmed the trial Judge's approach of not making a specific allowance for capital gains tax when determining the value of the property pool, rather the possibility of CGT arising was taken into account as a s 75(2) factor, at para 6.44:

> *"this is not a case in which we think the evidence was so clear, and the prospects of a sale of the entire business in the short term so likely, that in the absence of an order for its sale it was an error not to make such an allowance. Rather we think that it was within the proper exercise of His Honour's discretion to take the prospect of such a tax being incurred by the husband into account as a relevant Section 75(2) factor, as His Honour said that he did, and as we have no doubt that in fact he did."*

The judgment in ***Rosati*** (para 6.36) contains a succinct analysis of the reported decisions prior to that case:

> *It appears to us that although there is a degree of confusion, and possibly conflict, in the reported cases as to the proper approach to be adopted by a Court in proceedings under s 79 of the Act in relation to the effect of potential capital gains tax, which would be payable upon the sale of an asset, the following general principles may be said to emerge from those cases:--*
>
> *(1) Whether the incidence of capital gains tax should be taken into account in valuing a particular asset varies according to the circumstances of the case, including the method of valuation applied to the particular asset, the likelihood or otherwise of that asset being realised in the foreseeable future, the circumstances of its acquisition and the evidence of the parties as to their intentions in relation to that asset.*

(2) If the Court orders the sale of an asset, or is satisfied that a sale of it is inevitable, or would probably occur in the near future, or if the asset is one which was acquired solely as an investment and with a view to its ultimate sale for profit, then, generally, allowance should be made for any capital gains tax payable upon such a sale in determining the value of that asset for the purpose of the proceedings.

(3) If none of the circumstances referred to in (2) applies to a particular asset, but the Court is satisfied that there is a significant risk that the asset will have to be sold in the short to mid term, then the Court, whilst not making allowance for the capital gains tax payable on such a sale in determining the value of the asset, may take that risk into account as a relevant s 75(2) factor, the weight to be attributed to that factor varying according to the degree of the risk and the length of the period within which the sale may occur.

There may be special circumstances in a particular case which, despite the absence of any certainty or even likelihood of a sale of an asset in the foreseeable future, make it appropriate to take the incidence of capital gains tax into account in valuing that asset. In such a case, it may be appropriate to take the capital gains tax into account at its full rate, or at some discounted rate, having regard to the degree of risk of a sale occurring and/or the length of time which is likely to elapse before that occurs.

***JEL V DDF** (2001) FLC 93-075*

This was an 18 year marriage which produced three children. The wife's son from her previous marriage also lived with the parties. In the course of the marriage the husband (a geologist) literally struck gold, through a management buy-out of his employer's Australian mineral assets, and created the largest gold mine in Queensland. He subsequently sold his interests and went into other investments. By the time of the trial the assets stood at $44 million.

In considering the application of realisation costs and capital gains tax, the trial Judge, May J., identified the issues as being whether the realisation costs should be deducted from the whole of the pool or from only those assets to be distributed. Her Honour concluded that the realisation costs:

> "*should only be taken into account in respect of any assets which are actually to be sold or transferred pursuant to the orders of this Court or which must inevitably be sold to enable the husband to comply with such orders."*

She later also stated:

> *"While, of course, it is correct the assets have been acquired with a view to making a profit, the husband cannot fairly be allowed to assert that the wife should contribute to capital gains liability and other potential tax liabilities when it is far from clear when and if these liabilities will ever arise".*

The husband appealed that realisation costs should have been fully taken into account, not just partially applied, noting:

(a) the fact that the net assets were contained within a trust structure and the only way for the husband or wife to access the assets was to transfer them to themselves and/or convert them to cash which would attract realisation costs;

(b) that the net realisable method of valuation had been adopted by both accountants; and

(c) the fact that each and every asset of the parties and the Trust had been acquired for an investment with a view to ultimate sale at a profit.

The appeal was unsuccessful.

This appears to be an overly onerous application of the second limb of the ***Rosati*** principles, regarding the nexus between the purpose of the asset holding and an allowance for tax. While it was clear that certain assets had been acquired with a view to making a profit, and all of the assets were valued on a net assets basis, the uncertainty about the timing of such liabilities crystallising led to only a partial allowance being made.

Jarrott & Jarrott *(2012) FamCAFC 29*

This case involved an appeal from a decision of Cleary J to the Full Court of the Family Court of Australia. Relevant for the current purposes, the Full Court considered the correct expression of an order for the realisation of assets and the proper way in which to consider Capital Gains Tax (CGT) liabilities that "could" occur as a consequence of compliance with property settlement orders.

In the primary decision, the trial judge determined the parties' contributions to be 75% by the husband and 25% by the wife. This was adjusted by increasing the wife's entitlement by 10% pursuant to section 75(2) factors such that the assets were to be split 65/35 in favour of the husband. Such a conclusion resulted in an order that the wife receive a lump sum payment of $765,000.

As part of the property division, the trial judge also ordered that the former matrimonial home be sold. While it was not expected that there would be any net proceeds of sale after amounts for the cost of sale and mortgage were deducted, the balance, if there was any, was to be paid to the wife.

In reviewing this decision, the Full Court noted the authorities which confirm that, where orders require the realisation of assets, those orders should be expressed in percentage terms. This is necessary because, if the orders are not expressed this way and an asset is realised for significantly more or less than the values relied on at trial, then the overall percentage entitlements of the parties will be altered.

In this regard, the Full Court considered that, if the sale of the matrimonial home generated a surplus after the payment of agent's commission, legal fees and the mortgage, the wife would be entitled to that surplus as well as retaining her entitlement to receive $765,000. Such an outcome would increase the wife's entitlement above 35% and cause a corresponding decrease in the husband's percentage entitlement.

It was therefore, held that the trial judge had failed, when making her orders, to express those orders in percentage terms which was potentially to the detriment of the husband and contrary to the authorities.

The husband also submitted that in order to meet the wife's entitlement pursuant to the trial judge's orders, he would have to either borrow from or through the company in which he held a majority shareholder (the D company) or sell some shares in it. It was submitted that if the husband had to sell shares then this would, on balance, give rise to a Capital Gains Tax liability of $80,000 - $90,000. Further, a loan through the D Company which was not repaid within 12 months would also attract a tax liability. It was the husband's position that the trial judge had failed to take into account this cost.

The Full Court found that the trial judge had correctly accepted that a tax debt "could" arise in complying with the orders. However, the Court went on to note that failing to include that possibility in the balance sheet was not erroneous but, that having not done so, it was necessary to have regard to it in the context of the consideration of the section 75(2) factors.

The Full Court considered that the trial judge had accounted for the possible CGT event in making her percentage adjustment. However, it was not clear exactly how this had been done.

The Full Court noted that an "all or nothing" approach of either including CGT or not, but trying to take it into account under s 75(2) had the potential to visit an injustice upon one of the parties. If an allowance was made on the balance sheet, or pursuant to s75(2), and no CGT liability materialised, the wife would be disadvantaged. Alternatively, the husband could be disadvantaged if CGT did materialise and the trial judge had discounted that figure significantly in respect to s75(2) because its incidence was only a possibility.

The Full Court held that a CGT event was not inevitable and therefore, pursuant to ***Rosati v Rosati***, the appropriate course in this situation would have been to have made a contingent order, which would operate if and when a CGT liability arose.

Lovine & Connor and Anor *(2012) FamCAFC 168*

Again, the key relevant issue in this case related to an anticipated CGT liability, with the wife making a cross-appeal in relation to an allowance of $300,000 made by the trial judge. The CGT liability was associated with the potential sale of shares by the husband in order to fulfil his obligations under the orders made by the court, and had been taken into account by the trial judge when calculating the divisible pool.

The trial judge had calculated an overall division of 60%/40% in favour of the husband. In giving effect to these orders the wife was to receive, amongst other assets, cash payments from the husband.

The trial judge in this case had concluded that, in order to fulfil his obligations under the orders, the husband had three possible options. Those were:

(a) To sell shares and other property, which would be subject to CGT;

(b) To borrow the money, which would require the payment of interest from income as well as ultimately having to pay the principal amount; or

(c) To sell the property that was the primary residence, which would not be subject to CGT. However, the trial judge considered that the costs of the sale and of the purchase of another residence would not be dissimilar to the amount claimed by way of CGT.

The only evidence before the trial judge was the husband's own calculations (which were not accepted) as to the CGT liability that would be incurred if the whole of his share portfolio was sold. There was therefore no evidence as to the CGT liability if other property was sold, nor evidence of the cost of any borrowing, or the likely cost of realising the sale of the principal residence.

It was argued by the husband that there was a significant risk of the assets being sold in the short to mid-term and, in these circumstances, the court could take that risk into account as a relevant section 75(2) factor as per ***Rosati & Rosati***. However, the Full Court held that the fundamental difficulty with this proposition was that such an approach was referrable to the incidence of capital gains tax, upon the sale of a particular or specified asset . In this case, the judge had identified a number of possible alternatives, none of which were elevated as more likely than another, and which may incur costs other than the CGT or costs of asset realisation.

The Full Court considered that, as the husband had not established the quantum of his claim for realisation costs, there was no evidentiary basis for the learned trial judge's determination to allow a liability in the determined amount of $300,000. The Full Court, following ***Jarrott & Jarrott***, held that the trial Judge should have made orders such that, if the husband did incur a liability or legitimate realisation cost in selling assets to meet his liability under the Orders, then the parties should share in that liability in proportion to their beneficial entitlements as determined (i.e. in their percentage shares).

Other bits and pieces

7. GFC Cases (and other hard luck stories)

These cases remain relevant as the roller coaster economy is still in play, and while the peaks and troughs may not be as pronounced as the 2007 to 2009 period, the principles established give us a useful insight to how the Court might deal with changing fortunes.

Myerson & Myerson *UK Court of Appeal 2009 EWCA Civ 282*

In this case the husband was a fund manager, operating through a company known as "Principle Capital Holdings Limited" which was listed on the AIM Exchange (London Stock Exchange's international market for smaller growing companies).

It is noted in the judgment that the husband held a "very substantial share" in the listed company and that at the date of the compromise between the parties, February 2008, shares in Principle Capital Holdings Limited were £2.99 with the value of the husband's interest in the company being approximately £15 million. As part of the agreement reached, the husband was to pay the wife a lump sum of £9.5 million, by way of five instalments.

It was noted that shares in the company were not traded often, but that the shares traded at over £3.00 per share from May 2007 to February 2008. In March 2008, on the date the orders were made, the share price was quoted at £2.775, and the value of the shares was greater than £2.00 per share until July 2008. It appears that the shares in this case were significantly impacted by the Global Financial Crisis, with the share price declining to £1.62 at the end of September 2008, £1.40 in November 2008 and £0.725 in December 2008. At the date of the hearing in March 2009 the value was £0.275 per share.

In November 2008 the husband issued an application seeking variation of the initial orders, citing that the Global Financial Crisis and the collapse of the share price of Principle Capital Holdings Limited rendered the initial order "unfair and unworkable". At the date of the hearing in March 2009, and adopting the value per share of £0.275, counsel for the husband stated that the husband's share in the matrimonial pool of assets had diminished to minus 5.25% and the wife's share had risen to 105.2%. The original order had divided the assets at 57% to the husband and 43% to the wife.

Thorpe LJ. rejected the husband's appeal, while noting that the case had "dramatic features", citing the case of ***Cornick & Cornick*** *(No 1) [1994] 2 FCR 1189,* and agreed with Hake J.'s reasoning in this case that "*the natural processes of price fluctuation, whether in houses, shares, or any other property, and however dramatic, do not satisfy the Barder test*" (***Barder v Caluori*** *[1988] AC 20, 43* – identifying a set of circumstances which would suggest that relief could be made to prior court orders). Thorpe LJ. notes that the fluctuation in share price was simply a change in the circumstances of the parties, which had taken place since the orders were made.

Walkden & Walkden *UK Court of Appeal 2009 EWCA Civ 627*

The husband was a joint managing director of Triesse Limited ("Triesse"), and held 45% of the shares in the company. Triesse manufactured wood based panel processors and laminated boards. The husband valued his shareholding in the company on his Form E statement at £216,000.

The parties entered into a separation agreement in October 2005.

Subsequent to this date, an investment company, Sylvan International Limited ("Sylvan"), approached Triesse with a view to acquiring the company. The management accounts for the half year ended March 2006 demonstrated a pre-tax loss of £46,000. It was noted that negotiations for a possible sale terminated in May 2006. The approach by Sylvan was not disclosed to the wife.

During this period, the separation agreement mentioned above was varied in order to give the wife 5% of the value of the husband's shares in the event of a future sale. The wife requested that the husband agree to pay her £81,000 as substitution for the 5% of a possible future sale. The findings of the appeal Judges stressed that the wife was not required to convert the shares into cash but she voluntarily chose this.

In December 2006 the sales director resigned from the board of Triesse. On the basis of the value paid for his shares the value of the company was £585,000. Within this transaction, the husband acquired an additional 3% of the shares in company. The husband did not disclose either of these transactions.

In January 2007, during ancillary relief proceedings of the parties, and having been advised that the husband's shares in the company were worth significantly more than his estimate of their value, the wife negotiated to receive a further payment of £50,000 (her initial request was for £100,000).

In June 2007 Sylvan again approached Triesse. At this time the management accounts of Triesse showed a profit before tax of £353,000 and on the basis of those accounts Sylvan agreed to purchase the company for £3,700,000.

On the basis of this transaction the wife issued an application for leave to appeal and/or to set aside the consent order. Hunt J. granted leave to reopen the ancillary relief order, and this decision was appealed by the husband. The appeal judgment, led by Thorpe LJ. rejected the conclusion made by Hunt J and upheld the appeal made by the husband.

In the judgment Thorpe LJ, concludes that the sale of the husband's shares was not unforeseeable, as the separation agreement had initially been varied to account for such a sale. He also opined that the husband's non-disclosure of the valuation of the company when a director resigned, and the fact that the husband acquired more shares, was not to his advantage.

Elias LJ. stated in the judgment that "*it was plainly foreseeable that an asset of this nature might fluctuate dramatically. A minority interest in a private company is a notoriously difficult asset to value. The case falls within the terms of the analysis in **Cornick** and **Myerson**.*" and that "*the wife subsequently negotiated personally with her husband and agreed a further sum of £50k (in addition to the £81k already received) and chose not to obtain a formal valuation. The wife chose the certainty of a fixed sum.*"

Greenwood v Greenwood *(2009) Fam CA 787*

In this case, the parties owned a number of rural properties. A property settlement order was made by consent on 10 December 2008, pursuant to section 79A, and included the following provisions:

a) The husband was to pay the wife $5,750,000;
b) Upon payment, the wife was to transfer her interest in a number of rural properties to the husband; and
c) If the husband defaulted on the payment, a regime of sale of properties was to be undertaken, in a specific order.

The husband planned to pay the wife through a loan from the National Australia Bank. Subsequent to the finalisation of the orders, NAB withdrew its offer of finance and further demanded that it be paid out in full from the proceeds of sale of "property B". This would necessitate the sale of further properties in order to pay out the wife. Accordingly, the husband defaulted in payment of the lump sum to the wife.

Consequently, "property B" was unsuccessfully offered for sale by public auction. The orders included a second auction reserve that should be set, if the property was not sold at the initial reserve. The parties agreed not to list the property at a lower reserve as they believed this would be futile in the existing property market.

It was noted that a combination of factors, including the global financial crisis and serious floods in Queensland, resulted in a significant decline in the value of the subject rural properties. The husband submitted that these factors rendered it impracticable to carry out the consent orders.

Jordon J. dismissed the husband's application. He explained that the husband's application relied on four fundamental assumptions, which the husband had failed to communicate to the wife and the Court. In particular, there was no evidence in the orders that the whole payment to the wife was subject to NAB providing finance. In addition, the husband may have hoped that the rural properties would not need to be sold, but that this is also inconsistent with the orders consented to by him.

Jordon J. also noted that the failure to hold the second auction on "property B" was an agreement between the parties and did not strike at the core of the terms of the agreement to sell. The second auction of "property B" could still be held.

In summary, Jordon J. stated that essentially the husband's "*grievance is that, with the benefit of hindsight, it has proven to be commercially unprofitable to agree to pay the wife a fixed lump sum. Given his time again, the husband might well have included subject to finance clauses, rise or fall clauses or percentage distribution clauses, in lieu of or in addition to the terms appearing in the orders. He had an expectation of securing finance and that did not come to pass and the market has fallen. He took the risk of a lump sum order and the bargains he struck have failed him and have not borne fruit. He is disappointed and he may suffer a not insignificant financial consequence. However, in my view, these are nothing more or less than the exigencies of life and litigation. Both parties assumed risks by opting for a lump sum order.*"

8. Hindsight in business valuation

Pope & Pope *(2012) FamCA 204*

In this case the husband was a founding member of an entertainment group, founded in 1991. Health difficulties resulted in the husband's retirement from the group in 2006 with the remaining founding members acquiring his interest in the group for a significant sum. The husband retained royalty rights in relation to musical compositions assigned to the original entertainment group company, as well as royalties received by him personally from the Australian Performing Right Association ("APRA").

"P Pty Ltd" was incorporated in 1996 with the parties being equal shareholders and directors of the company. The company received income from sources including the husband's employment with the entertainment group and copyright royalties derived by the entertainment group company.

"PP Pty Ltd" was incorporated in 2008 with the husband being the sole director and shareholder. The principal purpose of this company was to carry out luxury property developments. The wife removed the husband as director of P Pty Ltd in 2009, and since this date PP Pty Ltd had received group related income including royalties. It was noted that the property development venture was unsuccessful and had resulted in losses of approximately $3.4 million.

A number of valuation issues were identified in this case, including the appropriate method for calculating retrospective valuations, the method of valuing royalty stream income, whether royalty income is considered a property or financial resource and the treatment of losses incurred in relation to the property development activities.

The parties disagreed about the value of the husband's interest in the group at cohabitation (April 1995). A "hindsight valuation" was performed by the single expert to determine the "value to the owner" of the group. The single expert explained that it was essential that only information that was "known or knowable" at the valuation date be considered in the valuation. This was explained as a key factor in the valuation due to "*the success of the group in the late 1990's and subsequent years, that is inarguably described as spectacular*". This necessitated the requirement to distinguish between the information that would have been reasonably available and discernible at the valuation date, as against the subsequent information that has become available as a result of the passage of time.

As detailed in the report of the single expert, there are two categories of subsequent events (i.e. hindsight) in a valuation such as this, as follows[1]:

(i) Those that affect value (which should not be considered unless the facts were knowable at the valuation date); and

(ii) Those that do not affect value but provide evidence of the value that existed at the valuation date (these may be considered).

Further, when a business continues on its historical path of normal growth or decline, the use of subsequent information is considered appropriate, particularly if the information from the earlier year is missing or not available. Where the business is affected by foreseen or predictable changes/events, subsequent information which reflects the foreseen or predictable event is considered appropriate. However, when the business is affected by unpredictable or unforseen changes/events, the use of subsequent information reflecting an unforseen event is not appropriate.[2]

The single expert adopted a capitalised future maintainable earnings methodology to determine the value held by the husband in the group as at April 1995. The entertainment group's profit and loss results for the year ended 30 June 1995 were utilised as a starting point for the calculation of maintainable earnings which was adjusted for knowable events, including touring and merchandise royalties, resulting in adjusted maintainable earnings of $1.2 million. A 6% capitalisation rate was applied to the maintainable earnings, resulting in an enterprise value of $7.2 million.

---

[1] See *"Should subsequent events be considered in the present value of a business"* Dr S Pratt, BVUpdate March 2002 published by Business Valuation Resources LLC, see also the Handbook of Advances Business Valuation.

[2] See Lonergan "*The Valuation of Businesses, Shares and Other Equities*" fourth edition page 594.

It was noted that there were $Nil net tangible assets of the business at the valuation date, as per the 1995 financial statements, resulting in the business being valued at $7.2 million and the husband's interest being $1.8 million. The valuation was accepted by the husband but challenged by the wife.

Known events considered by the single expert included that the idiosyncratic features of the group's character had been established, five albums and six videos had been released, the group members were engaged full-time as entertainers and the venue type and frequency of performances were improving, a third music agreement had been signed which included the right to negotiate the release of records in places other than Australia and New Zealand, the conditions of the third agreement had significantly changed in comparison to the initial music contract and group merchandise was being sold. It was noted by the single expert that it was not until about mid-1996 that the group began to fully explore their merchandising potential, but in her opinion it was reasonable to assume that if the group had tested the merchandise market at the valuation date, terms consistent with those achieved in a merchandise agreement in 1996 would have been attained in 1995 and that therefore this was knowable at the valuation date.

She also opined that it was reasonably foreseeable, as at the valuation date, that the group would have achieved some level of success overseas, on the basis of the success of an Australian multimedia corporation. However, she opined that there was no possibility that the ultimate success achieved in the USA, was reasonably foreseeable, or knowable, at the valuation date.

Ryan J. agreed with the opinion of the single expert, including the value of the husband's interest in the group at $1.8 million at April 1995.

9. Employee stock options

Hurst v Webber *(2009) FamCAFC 137*

The husband in this matter was an employee of "W Limited" and held employee share options in the company.

The options the husband held at trial were valued by an accountant, who, as stated by Ryan J. in the appeal, clearly explained in his report that in valuing the *intrinsic value* of the options, i.e. the value that can be immediately realised by the employee, subject to satisfying vesting conditions, he applied a discount *"for the risk that the performance hurdles may not be met and therefore some of the options would be forfeited"* as per the *Black and Scholes* method of valuation.

Baumann FM had accepted the value of the employee options as determined by the accountant but concluded that the shares should be regarded as a future financial resource to the husband, not as an asset due to the performance hurdles, including remaining employed with the company, which was required in order for the options to vest.

As opined by Ryan J., Baumann FM erred in this regard, stating that if "*a particular asset is property as defined by s 4 of the Act then it remains property and it cannot be treated as a financial resource*." Ryan J. noted that there may be particular characteristics of an item that need to be carefully considered pursuant to s75(2) (o), however in this case, due to the uncontroversial and uncontested evidence as to the value of the unvested share options, they should have been treated as property.

We note that this was not the unanimous decision of the Full Court, as Warnick and Boland JJ. concluded that the value of the share options was only 5% in respect to the other assets and that therefore they were satisfied that the inclusion of the options in the asset pool, as opposed to treating them as a financial resource, would not have made any difference to the outcome.

Nielson & Nielson *(2012) FamCA 70*

In this case, the key valuation issue considered was whether the husband's employee options and conditional rights should be included in the pool of assets of the parties, or treated as a financial resource.

It was noted by Loughnan J. that the parties had reached a compromise as to the value of the unvested options and conditional rights held by the husband as $371,360. The agreed figure was specified to be the mid-point between the values determined by the parties' respective valuers.

It was submitted that a series of discounts were made before each expert arrived at their opinion of the value, including restrictions relating to transferability, illiquidity, timing and the risks relating to the husband ceasing employment with the company or not meeting performance hurdles.

It was noted that the valuer for the husband stated that he had valued the options as if they could be sold, but that in his opinion the options could not be sold. Loughnan J opined that "*it is not the case that something is property only if it can be sold*".

Loughnan J. concluded that it was appropriate to include the shares, options and rights as property and also noted that after the trial he was referred to the Full Court decision of ***Hurst v Webber***, which although not unanimous, supported his decision.

10. Relevance of a an "indicative offer"

Pitt v Pitt *(2011) FamCA 172*

The husband and wife in this matter were the shareholders and directors of "R Pty Limited", which conducted a food manufacturing business which sold products both domestically and internationally.

At issue in the proceedings was a *"non-binding indicative offer"* made by "G Limited" for the purchase of the business and assets of R Pty Limited.

The non-binding indicative offer was made by G Limited, the sole domestic competitor to R Pty Limited, following a unilateral approach by the wife to the manager of G Limited to ascertain whether it would be interested in acquiring R Pty Limited. The non-binding indicative offer, which was later withdrawn, provided an estimated price for the business undertaking of R Pty Limited.

The expert for the wife placed weight on the non-binding indicative offer, stating that it provided *"the view of an informed and independent third party, which enjoys substantial knowledge of the particular sector of the market in which [R Pty Limited] operates, of the fair market value to pay for [R Pty Limited]"*. The expert considered that the non-binding indicative offer was relevant and was a factor to be relied on when determining an appropriate earnings capitalisation multiple as G Limited was a listed company which was comparable to the subject company and manufactured a similar product.

The single expert in the matter had a different opinion, preferring not to attribute any significance to the terms of the non-binding indicative offer. The single expert considered that the non-binding indicative offer *"cannot be considered to be by a normal purchaser, because it is the only competitor and the price that they might be prepared to pay might carry a premium because they are taking out a competitor"* and expressed concern as to the relevance to the valuation of a "non-binding indicative offer, since withdrawn".

Rose J. accepted the submissions made by senior counsel for the husband that the non-binding indicative offer *"does not attract any weight in terms of evidence of value and represents nothing more than an early stage to a possible offer"* and confirmed that *"it is well established that offers do not represent evidence of value"*, citing ***Barker & Barker*** [2007] FamCA 13, which in turn cited a range of cases, including the Full Court of the Federal Court in ***Cordelia Holdings Pty Ltd v Newky Holdings*** *[2004] FCAFC 48*, which observed that *"whatever weight may be properly given to evidence of offers for limited or general purposes, it is clear that such evidence is not permissible as direct evidence of value."*

11. Valuing liabilities

Due attention is ordinarily given to the valuation of assets, be they personal or business, tangible or intangible. The proper valuation of liabilities is often overlooked as it is assumed that their market value equates to their face value or the value at which they might be reported in a set of financial statements. This is not always the case. For example, the fair market value of a loan issued on concessional terms may differ materially from its notional face value.

When valuing a liability, the liability should be measured on the basis of its present value expressed in today's dollars (ie a sum of money payable in the future is discounted to convert it into today's dollars).

The discount rate to be applied in determining the value of a liability should be the notional rate at which it would be possible to pay out the indebtedness today. That is, the value of the liability can be calculated as if the indebted party were to pay the creditor a sum of money today (which would be the present value of the liability to pay capital and interest discounted at an appropriate prevailing rate of interest) to discharge the debts as and when they fall due.

In the unreported decision of O'Ryan J in ***O'Connell's Case*** *(1996)*, the real value of a liability with a $600,000 face value was determined to be $265,000, after proper regard was given to the long interest free period over which the loan was repayable.

12. Trust attribution to beneficiaries

AC and ORS & VC and Anor *(2013) Fam CAFC 60*

In this case, a discretionary trust was established by a Deed of Settlement dated June 1985, with a vesting date of June 2064. The Guardian and Appointor of the trust was the husband. The specified beneficiaries were the husband, wife and their adult children. The original trustee was the husband's father, but by a Deed of Appointment made in August 1985, the husband substituted a corporate trustee. The husband and his father each held one of the two issued shares in, and were directors of, the corporate trustee.

During February 1997, the husband resigned as Appointor and Guardian of the trust and as director of the trustee company. Prior to the husband's resignation, he did not appoint another Appointor or Guardian and there was no Appointor or Guardian subsequently appointed.

Between April 2001 and January 2004, there were changes in the shareholding in the corporate trustee which resulted in the husband's father holding the entire shareholding. When the husband's father died in 2008, that entire shareholding was passed to, and remained with, the husband's mother, who along with another person had been appointed as additional directors of the trustee company.

As there was no Appointor or Guardian of the trust, the trial Judge found that the specified beneficiaries had a *"fixed and irrevocable entitlement to a share of capital upon a vesting of the trust"* resulting in the capital of the trust being distributed to the specified beneficiaries in the event the trust vested. The trial Judge held that this circumstance gave the husband and the wife a sufficient interest in the trust to justify the Court using it third party powers under Part VIIIAA of the *Family Law Act* to require the trustee to cause the trust to vest. The capital of the trust had been valued at $6,565,391. From this amount, the trial Judge allocated $338,000 to the husband's mother on the basis that she was a general beneficiary, the level of distributions she had received in the past and her life expectancy. Of the balance, the specified beneficiaries were to receive a distribution of $1,245,478 each.

On appeal by the husband's mother and other third parties, the Full Court held that the entitlement of the husband and the wife to share in the capital of the trust on vesting was property for the purpose of s79 of the *Family Law Act*, and, adopting the submission of the intervening Commonwealth Attorney-General, that Part VIIIAA of the *Family Law Act* can be used to require a trustee (including a third party trustee) to bring forward the vesting date of a trust fund in order to value and distribute an irrevocable entitlement to share in a trust fund and that the powers under Part VIIIAA can be validly exercised at the expense of third party interests provided the requirements in ss 90AE(3) and (4) and ss 90AF(3) and (4) are met, and the Order, if made under s79 is "just and equitable" or "proper" if made under s114.

13. Obligation not to make use of documents

As practitioners, from time to time we are requested to execute Confidentiality Agreements. Are they necessary?

The recent case of ***Commissioner of Taxation & Darling***, which has made its way to the High Court, warrants a special mention in our "Other bits and pieces" section. Before considering ***Darling***, two earlier decisions, from other jurisdictions, are worthy of mention:

Harman v Secretary of State for the Home Department *(1983) 1 AC 280*

Mr Harman was instructed by a prisoner suing the home office for damages after being detained in extremely harsh conditions. Several documents were read in open court during the trial, but were **not** admitted into evidence. Harman lent copies of the documents to a journalist who had been present when the documents had been read in court. The journalist subsequently published a newspaper article criticising the home office.

The House of Lords upheld an order holding Harman in contempt, accepting that an implied obligation not to use documents obtained in the course of litigation for any purpose other than for the proper conduct of the action for which they were obtained, except with leave of the court, attached to any documents received by a party or legal practitioner during legal proceedings. There was also unanimous agreement that the implied obligation no longer applied to documents that were received into evidence.

However, the Lords were divided on the consequences of a document being read into open court, but not received into evidence. The majority reasoned that the implied obligation did not depend on whether documents were confidential or had been revealed in public. The majority held that the implied obligation *"affords a particular protection accorded in the interests of the proper administration of justice. It is owed not to the owner of the documents but to the court".* The important issue was considered to be whether Harman had been granted leave to use the documents for another purpose. Dissenting, Lords Scarman and Simon held that the implied obligation did not continue once the contents of the documents were no longer private or confidential.

Hearne v Street *(2008) 235 CLR 125*
(A case of topical interest, with Luna Park being the venue for the gala dinner of the 16th National Family Law Conference)

The High Court in *Hearne v Street* considered the implied obligation not to make use of documents obtained in litigation other than for the purpose for which they were provided in detail and has become the leading authority on the issue.

In this case, residents living in North Sydney began court proceedings against the operator of Luna Park, Luna Park Pty Ltd (***Luna Park Sydney***), alleging the tort of nuisance and complaining that noise from the amusement park was excessive. While the nuisance proceedings were underway, Mr Hearne, managing director of Luna Park Sydney, and Mr Tierney, director of an associated company, lobbied the NSW Government to introduce legislation to protect Luna Park Sydney against noise complaints, including those raised in the proceedings

In April 2005, shortly after the nuisance proceedings commenced, The Daily Telegraph published an article under a headline referring, in fairly disparaging terms, to the residents' allegations and summarising parts of their affidavits.

Solicitors for the residents complained that Luna Park Sydney had released the affidavits to the newspaper and sought appropriate undertakings from Luna Park Sydney. The proceedings continued and, under orders made by the court, an expert's report and a further affidavit were prepared by the residents and served on Luna Park Sydney.

Subsequently, both Mr Hearne and Mr Tierney provided copies of the expert's report and extracts from the further affidavit to individuals in the office of the Minister for Tourism, Sport and Recreation as part of their dealings with the NSW Government in relation to the proposed legislation.

The residents brought contempt charges against Mr Hearne and Mr Tierney, alleging breach of the implied undertaking. The charges were dismissed at first instance, but upheld on appeal by the NSW Court of Appeal (Justices Ipp and Basten, with Justice Handley dissenting).

The court articulated the obligation in these terms:

> *"Where one party to litigation is compelled, either by reason of a rule of court, or by reason of a specific order of the court, or otherwise, to disclose documents or information, the party obtaining the disclosure cannot, without the leave of the court, use it for any purpose other than that for which it was given unless it is received into evidence."*

The types of documents to which this applies were stated to include documents and information that one party to litigation is compelled whether by rule of court, a specified order, or otherwise to disclose, including:

- documents inspected after discovery;
- answers to interrogatories;
- documents produced on subpoena;
- documents produced for the purposes of taxation of costs;
- documents produced under a direction from an arbitrator;
- documents seized under an *Anton Pillar* order;
- witness statements served under a judicial direction;
- affidavits; and
- expert reports

The court considered that it was not only parties to litigation that would be bound by such obligations stating:

> *"The primary person bound by the relevant obligation is the litigant who receives documents or information from the other side pursuant to litigious processes. The implied undertaking also binds others to whom documents and information are given."*

The majority went on to reject the appellants' argument that the implied obligation is analogous to an injunction. The majority held that the implied obligation is an obligation of substantive law which arises from the circumstances in which material is generated and received in the course of litigation. Therefore, in order to establish a breach of the implied obligation, it is only necessary to show that the person bound by it:

- knew of the facts which gave rise to the obligation (i.e. that the material was generated and received in the course of litigation); and
- used the material for an ulterior purpose.

It is therefore not a defence that the person bound by the implied obligation was unaware of the obligation or its consequences.

The court also confirmed that although this is an obligation which can be "*released or modified by the court, that dispensing power is not freely exercised, and will only be exercised where special circumstances appear.*" (Staughton LJ in *Esso* as quoted in *Hearne).*

Commissioner of Taxation v Darling & Anor *(2014) FamCAFC 59*

The importance of this case relates to the Full Court releasing the Australian Taxation Office from the implied obligation not to make use of documents obtained from a family law case.

Mr and Mrs Darling were parties to proceedings in the Family Court which were dismissed by consent in 2010. Before the dismissal, in 2009, the ATO had commenced an audit into Mr Darling's tax affairs, and had written to the Family Court seeking advice about how to access documents in the current proceedings.

ATO officers attended the Melbourne registry in 2009, and were given permission by the Registry Services Manager to examine the file. Subsequently, the ATO sought to copy a number of those documents pursuant to rule 24.13(1)(c) of the *Family Law Rules 2004*. While initially denied by the Registry Manager, upon receipt of a further letter from the ATO asserting power to access the file pursuant to s263 of the *Income Tax Assessment Act 1936,* officers were allowed to make copies of the documents.

In 2012 the Commissioner sought leave to intervene in the Family Court proceedings, with a view to seeking that the Commissioner be released from the obligation not to make use of the documents. The documents concerned were affidavits and financial statements of Mr and Mrs Darling, sworn by the parties for the purposes of the proceedings.

Leave was not granted by the primary judge and so the Commission appealed to the FamCAFC.

The Full Court allowed the appeal based on the erroneous exercise of the primary judge's discretion in accepting submissions that the Commissioner was obliged to, or had failed to, provide certain evidence. The court chose to re-exercise the discretion in favour of the Commissioner for a number of reasons, including that:

(a) The Commissioner was performing an important public duty and the public interest is advanced by ensuring all taxpayers pay their share of tax;

(b) The Commissioner was engaged in a substantial, targeted audit (not a 'random audit');

(c) The parties' own assertions about the history of acquisition of assets would only be available to the Commissioner by interview with the parties in which they may have an incentive not to be frank;

(d) As the ATO was at that point only conducting an audit, cogency of the evidence would be the subject of scrutiny in any proceedings after the audit is completed;

(e) There was no explanation to support the assertion that the release from the obligation would be "inconvenient" to Mr Darling or cause him any prejudice;

(f) The Commissioner would be restricted in the way in which the information can be used such that the documents would not venture into the public arena and therefore ensuring there was no breach of s 121 of the FLA;

(g) The affidavits were sworn by the parties for the purposes of the proceedings and in the expectation that they might be read in open court. Having served the documents, the decision as to whether the documents would pass into the public domain moved from the control of the party who filed them. The court noted that whilst in no way determinative, this was a factor of significance;

(h) The ATO had sufficiently stated the purpose for which the documents were required; and

(i) The subpoenas the Commissioner wished to use could not have contained any confidential information, nor could the application documents.

The Court considered the most important factor to their decision to be whether or not granting the Commissioner relief would likely discourage full and frank disclosure in future family law matters.

The Court noted that there was already a heavy obligation on litigants in Family Court proceedings to make such disclosure. The Court also considered that there **already** existed a disincentive to litigants to be frank because it was well-known that the court could, and has, referred matters of tax evasion to the authorities. The Court was not persuaded that relieving the Commissioner of the implied obligation in some cases would result in any **greater** disincentive to parties to be frank with the Court.

14. Section 81 – "Clean break"

Jong v Yeng *(2014) FamCAFC 156*

The key complaint in this appeal to the Full Court was the wife's assertion that the trial judge's orders did not entirely sever the financial relationship between the parties, instead leaving both the husband and wife with their respective interests and shares in a family company.

The husband and wife were sole directors and shareholders of a company, B Pty Ltd, which bought and developed properties.

B Pty Ltd purchased property with W Holdings Pty Ltd, the sole directors and shareholders of which were the wife's parents. Both companies also entered into a development project with K Enterprises Pty Ltd, a company of which the wife's brother and sister-in-law were directors and shareholders.

When the family proceedings were commenced, W Holdings, K Enterprises Pty Ltd and B Pty Ltd were named as parties by the husband as he claimed they had debts to B Pty Ltd arising from joint developments. The husband contended that these claims should be heard in the property settlement proceedings using the accrued jurisdiction of the Family Court.

In the initial proceedings, the trial judge, however, found that the claim did not have the necessary connection to fall within the accrued jurisdiction of the Family Court and therefore could only be relevant in the property hearing as to the valuation of B Pty Ltd. It was further found that the husband was not the proper plaintiff to the claims because the debts were asserted to be owed to B Pty Ltd, not the husband personally. This aspect of the decision was not appealed.

The principal assets available for division in the proceedings between the husband and wife were four properties; one owned personally by the wife, and three others owned by B Pty Ltd with W Holdings and/or with K Enterprises Pty Ltd. These assets were treated by the parties as if they were the property of the parties, themselves.

There was also an issue concerning the extent to which the wife's parents had made contributions to the parties and to the children.

The wife sought, amongst other things, a transfer of the husband's shareholdings in B Pty Ltd.

The primary judge considered the wife's submission that orders should be made so as to finally determine the financial relationship between the parties and avoid further proceedings between them, pursuant to s 81 of the Family Law Act. However, the trial court observed that s 81 of the Act is a duty, not a head of power and, while the court "*strives as far as practicable to endeavour to fulfil such duty... there are some cases where the Court is unable to fulfil this duty.*"

After finding that an equal division represented an equitable outcome, the trial judge considered that he was unable to make an order finally severing the financial relationship by transferring the husband's interest in B Pty Ltd to the wife (or vice versa) because:

(a) The value of the company's assets was well in excess of 50% of the value of the total property pool;

(b) If the husband was required to transfer his share to the wife then this would either remove him from, or make it very difficult for him to bring any claim he might have in equity against the corporations of the wife's parents and brother and such a result would be unfair to him;

(c) There was no evidence before the court about what the taxation implications might be of requiring the parties to transfer their interests in the corporation B Pty Ltd or its assets to one or other of them; and

(d) The parties had managed their financial affairs in such a manner as to enmesh their affairs with those of the wife's parents to such an extent that the court could not be reasonably expected, given its jurisdiction in respect of matrimonial causes, to "unwind... the entirety of the consequences of such enmeshment".

In this regard, the court considered that the best it could do to make an order that was just and equitable in such circumstances was to leave the parties with their interests and rights as shareholders of B Pty Ltd with the expectation that once the disputation about the matrimonial property was brought to an end, the parties may cause the corporation to be wound up or otherwise resolve the issue between themselves.

The Full Court agreed with the trial judge's conclusion that the issue of asserted debt owed to the wife's parents' company by B Pty Ltd, should be determined in subsequent litigation.

The Full Court agreed that this case was one of the exceptional cases in which just and equitable orders which brought the parties' financial relationship to an end were not possible. Therefore, the parties' financial ties could not be severed and the appeal was dismissed.

It is also evident that this is a case where there was only so much the court could do with the evidence that was before it. The absence of evidence from relevant parties, about key aspects of the case, could not be rectified via appeal to the Full Court.

The disclaimer …

This paper is not intended to be a comprehensive statement of law or practice and must not be relied on as such. If specific advice is required it should be sought on a formal professional basis. The paper has been prepared with due care and diligence however no warranty is given as to accuracy and completeness of the information contained herein.