VALUE TO THE OWNER IN THE CONTEXT OF FAMILY LAW FORENSIC ACCOUNTING PRACTICE

Paper presented by Trevor Vella, Director, Trevor Vella & Co Pty Limited
ICAA Forensic Accounting Conference, Melbourne September 2009

PART A: INTRODUCTION

1. This paper is an endeavour to explore what “value to the owner” [“**VTO**”] means and to make some comments upon how practitioners called upon to provide valuations in the Family Law context might go about forming a view on the quantum of value to the owner

2. “Value to the owner” is a “standard” of value. It is the objective of the valuation exercise, not a methodology for valuation. The Family Court has applied a VTO standard in several well-known cases [discussed below], most of which deal with the valuation of minority interests in family companies where there is an expectation that the shareholder husband/wife will ultimately derive a benefit more or less equivalent to the rateable[1] interest in the underlying worth of the relevant company. In these cases, the “market value” standard is rejected on the basis that it is not “realistic”. However, there has been little discussion of what “realistic” means”. Warnick J comments in *Ramsay* that it is in fact market value which is “realistic”, and that “value to the owner” may not be “realistic”, so that what is needed is a *“”realistic” value to the owner*” [see paragraph 53 below], with, at the same time, clear recognition in the valuation process, or at least in the property division process, of market value [or lack thereof].

3. This area is potentially very confusing for valuers. Factors contributing to the confusion include:

   a. the historic reticence of the Family Court to say what “value to the owner” means [beyond use of the term “realistic”], possibly influenced by a concern not to fetter discretion to tailor a decision to the particular circumstances of each case or perhaps simply because of a perception that the meaning is self-evident;

   b. uncertainty as to how to deal with assumptions as to “special benefits” – there have been suggestions that valuers should avoid the temptation to become involved in speculation about future events which are best left for the Court to deal with [see paragraph 65]. Does this mean that valuers should only express a view about market value? How is this view to be reconciled with the view, commonly propounded, that the valuer’s objective in every instance of Family Law valuation practice is to form an opinion as to value to the owner?;

   c. valuers are used to dealing with market value/fair market value/fair value (in the accounting sense) [we proceed on the basis that these represent the same thing – see Appendix A];

   d. the blurring in many decided cases, other than Family Law cases, of the distinction between market value and value to the owner, sometimes described as “real value”[2], often through the fiction of a “hypothetical” willing buyer where no buyer in fact exists (or at least none who will pay the value attributed by the Court to the asset in question).

---

1 Pro rata, in line with the proportion of ordinary shares held.
2 Although that term itself is used differently in different cases.

4. It is useful to bear in mind a general admonition not to slavishly follow what one or other judge said in a particular case. The fact that a particular discount rate or methodology was applied in one case does not give rise to any obligation for a valuer, let alone a judge, to apply that rate or methodology, even if the facts are identical [the facts are rarely identical]. However, statements made by judges about what a valuer is supposed to be doing often have "precedent significance" and should not be ignored. This is particularly relevant as regards value to the owner because, as stated above, that is a "standard of value" – the object of the exercise, not a valuation methodology. It is not unreasonable to expect that the Family Court would explain what objective is sought to be achieved, without necessarily making general pronouncements about how valuers should go about achieving that objective.

5. Notwithstanding the comments in the previous paragraph, an examination of valuation methodologies [as distinct from "standards"] considered by judges of the Family Court can be of general assistance to practitioners who have the opportunity to see what methodologies are propounded by other practitioners and how these withstand scrutiny.

PART B: VALUE TO THE OWNER AS A GENERAL CONCEPT: WHAT IS IT?

Value to the owner vs market value

6. The concept of "value to the owner" was not invented or created by the Family Court of Australia. Further, it is posited that the interpretation of the concept as applied by the Family Court is not novel. In this Part we review briefly the generally understood meaning of the term.

7. At the commencement of a paper[3] presented at the 2006 ICAA Conference Brendan Halligan reproduced an extract from Bonbright[4] dealing with the problem of defining "value". Later in the same chapter of this work, Bonbright describes "*two distinct though related major concepts of property value*". The following extract is a little long but well worth the reading:

> "………it would seem to follow that the value of property should always be taken to mean value to some specific individual or group of individuals, who have or may have an ownership interest in the thing. A chair, a residence, a railroad right of way, and an electric-light franchise, considered solely as objects of property, have no value except for the advantages that they may confer upon whatever persons may claim a special legal interest in their exploitation through use or sale. But since any object of wealth may be capable of conferring different advantages on different owners — as in the case of a pair of eyeglasses, which is adapted to Smith's eyes, but which would be of no possible use to Jones — one cannot properly speak of the value of a property in general; instead, one must speak of its value to some specific person or group of persons. Strictly construed, therefore, property value should mean invariably value to some particular owner.
>
> **Much of the literature, both of law and of professional appraisal, is friendly to this restriction of the value concept, to that of value to the owner. In many of the reported cases, for example, one finds statements to the effect that the market price or market value of property does not necessarily measure "real value," and that it is usually taken as a basis of valuation only because, as a rule, no more trustworthy measure of this fundamental value is available. "Real value" is often apparently taken as a synonym for the more revealing term "value to the owner**."

3 Brendan Halligan, *Some Concepts of Value*, portion of paper BV11 *Valuations and the Concept of Value in the Legal Environment*,, ICAA Business Valuation & Forensic Accounting Conference, the Westin Sydney, September 2006.

4 James C Bonbright, *The Valuation of Property* (1937), Charlottesville, The Michie Company, at pp.15-16

But in law, as in economics and in business, **value is often used in an associated sense, as a synonym for market price or market value**. "The worth of a thing, is the price it will bring," in the words of a jingle frequently repeated by judges as well as by economists. When the term is thus construed, no property, however valuable it may be to the particular individual for whom it is specially adapted, has any *value* unless it can be sold to some other person, and the amount of this value is always determined by the price at which it can be sold……….

This identification of value with market price, for which the classical economists are perhaps primarily responsible, **does such violence to the spirit of the word that its abandonment might well be urged, were it not too late to hope for success in this direction**. But the linguistic tradition is too firmly entrenched to be upset in the interest of scientific terms. **We are therefore forced to recognize two distinct though related major concepts of property value, the one referring to sale price, the other referring to value to a specific owner or group of owners**. The resulting ambiguity will not be serious if its presence is constantly observed and the distinction, in all its implications, clearly recognized. Such a distinction is generally recognized even today in the law cases, but its full import is not always appreciated. In consequence, **the value concepts of the courts betray a tendency to slide over unconsciously from the idea of value as mere sale price to the idea of value as worth to the owner**. We stress this point in the next chapter on market value, where we note the invocation of vague ideas of *fair* market value, or of prices as fixed by mythical willing buyers and willing sellers, which are confused straddles between the two meanings of value stated above." [emphasis added]

8. This was written in 1937. As Mr Halligan commented[5] in 2006, "*Not much has changed in the last 70 years*": it remains the case that there is much discussion on how to effect a valuation but little on what "value" means. A classic example of the "slide" referred to by Bonbright in the penultimate sentence of the above extract may be seen in the decision of Griffiths CJ in *Spencer's* case[6]:

"In my judgment the test of value of land is to be determined **not by enquiring what price a man desiring to sell could actually have obtained for it** on a given day, i.e., whether there was in fact on that day a willing buyer, but by enquiring: '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 anxious to sell.'" (emphasis added)

What the Court was seeking was a "deprival value" [value to the owner] commonly adopted in resumption cases. Indeed, *Spencer* was not a share valuation case but dealt with compensation for resumption of real estate by the Commonwealth. However, the Court created a notional[7] purchaser who would pay a "fair price" (the value to the owner) even thought there was in fact no purchaser willing to pay that price.

9. Many of the cases decided in the subsequent 100 years which have cited *Spencer* treat it as defining a "willing buyer, willing seller" test so as to reflect a market value standard. I don't propose to enter that discussion here, but it is clear that *Spencer* is a case about value to the owner[8], not about market value.

How is "value to the owner" ordinarily defined?

10. The International Glossary of Valuation Terms ("**the Glossary**") is promulgated by, and applied by, five valuation bodies, four in the United States and the Canadian Institute of Chartered Business Valuators. It contains a definition of "Investment value" defined as follows:

---

5 Halligan, supra, at para 1

6 *Spencer v The Commonwealth* (1907) 5 C.L.R. 418, at p432, per *Griffiths* CJ. See also per Sir Edmund Barton at pp 435-6. Contrast the greater focus on the "prudent purchaser" by Isaac J at pp440-1 .

7 Not "hypothetical" in the commonly used market valuation sense – someone who is representative of prospective buyers known, or reasonably believed, to actually exit.

8 Reference may be made to the discussion of *Spencer* in the paper presented by Brendan Halligan at the 2006 FASIG Conference. The case itself repays reading.

Investment Value - the value to a particular investor based on individual investment requirements and expectations. {NOTE: in Canada, the term used is "Value to the Owner"}.

This definition is thus a definition of “value to the owner”.

11. The International Valuation Standards Committee standards contain no definition of, or reference to the term, “value to the owner”. Standard IVS 2 – *Valuation Bases Other Than Market Value”* contains a definition of “investment value” as follows:

“Investment Value, or *Worth.* The value of property to a particular investor, or a class of investors, for identified investment objectives. This **subjective concept** relates specific property to a specific investor, group of investors, or entity with identifiable investment objectives and/or criteria. The *investment value,* or *worth,* of a property asset may be higher **or lower** than the *Market Value* of the property asset. The term *investment value,* or *worth,* should not be confused with the *Market Value* of an investment property. However, *Market Value* may reflect a number of individual assessments of the *investment value,* or *worth*, of the particular property asset. *Investment value,* or *worth* is associated with *Special Value*.” [**bolding added**]

12. The definition is similar to that in the Glossary and again we may conclude it coincides with a definition of “value to the owner” as used in Canadian terminology. We consider below [see paragraph 16 below] the proposition that investment value/VTO is subjective. We consider first the proposition in the above extract that VTO can be less than market value.

Can value to the owner be less than market value?

13. If the market value of an asset is $500,000 how can it be worth less to me than that? As a matter of logic, the answer is it can’t be “worth” [in the sense of an equivalent amount of money] less unless [and there may be other possibilities]:

a. “Market value” is determined by reference to market price and the holder [or a prospective holder, if one is seeking to determine VTO to a prospective holder] of the asset expects the market price to fall [consider share market analyst’s reports recommending a “sell” – this invokes what Pratt describes as a further standard of value called (by Pratt) “intrinsic value”; or simply the belief, whether based on detailed analysis or not, that an asset is “overvalued”] and therefore will wish to sell [or not buy, in the case of a prospective holder] the asset;

b. by “worth” or “value” we mean the amount of income which might be generated from its indefinite use [rather than by sale]. One could well envisage, for example, the situation where the prospective income flow from a business may be significantly less to Smith, a poor businessman, than to the “average” businessman making up the market of prospective buyers. Or consider the situation where Smith is a good operator but the market is peopled by prospective buyers who could capture synergies from the merger of Smith’ business; or

c. the holder holds an asset of a *type* which has a market value but he/she is restricted from selling the asset - but in such a case one might argue that the specific asset being valued does not have a “market value”. A classic example of this type of situation arose in the attempts to interpret what “value to the taxpayer” meant in sec 26(e) of the Income Tax Assessment Act 1925. Taxpayers argued that the worth to them of, for example, a free (but inalienable) holiday, was minimal because they would not be prepared to pay anything to acquire it. The section was eventually replaced by the fringe benefits tax regime, which taxes based on cost rather than value, because it was unworkable.

14. Of course if we are looking at assets other than business assets, the proposition that VTO may be less than market value is easier to conceive. Mr Bonbright[9] gives the example of "*a pair of eyeglasses, which is adapted to Smith's eyes, but which would be of no possible use to Jones*". The implication is that, while the market price of the spectacles is significant, the VTO to Jones is nothing, although the position may be different if Jones is a vendor of spectacles.

Under what circumstances will owner value equal market value?

15. In the example at paragraph 13.b above we envisaged Smith as being unable to exploit the advantages which would be available to other prospective owners of the asset. In such a case, if Smith is able to sell the asset, the value to him cannot be less than the sale price (ie market value) less costs of sale [and less tax because we are measuring the money equivalent of the asset]. The value to Smith cannot be any more that the market value [plus acquisition costs] if Smith can readily replace the asset with one that is "equivalent" at the market price, because replacement places him in exactly the same position as he is in presently. [The position may be a little more complicated if, for example, the asset held has a low cost base for tax purposes while the replacement asset has a cost base equal to its market value.] Leaving aside costs of sale and taxes, then, if there is a deep and stable market where Smith can buy and sell commodity X at price $Y, then value to the owner must be equal to market value.

Is owner value subjective?

16. "Market value" is generally seen as an objective measure of value[10]. The degree of actual objectivity in practice may vary. At the extremes:

    a. there is a deep and highly liquid market for the commodity being valued [eg shares], or very similar commodities [eg land], so that one can reasonably form the view that market price represents the amount which would be paid to a willing seller by a willing buyer – in such circumstances the exercise can reasonably be described as "objective";

    b. there is no observable market and the valuer infers value based on generally accepted methodologies which rely essentially on developing a discount rate, capitalisation rate or multiple based on perceived relative risk and, in some cases, extrapolating appropriate marketability and minority discounts from observed data or perceptions of market practice – in such circumstances the exercise may still be seen as "objective" but there are certainly subjective elements which depend on the judgment of the valuer.

    The Glossary talks about "*the value to a particular investor based on individual requirements and expectations"* and that certainly carries a subjective flavour.

17. It is postulated that the subjective element of a value to the owner assessment is minimised if:

    a. the valuer seeks to determine not what is in the mind of the actual owner but rather what a reasonable person in the position of the owner would see as the value – this is the common approach to a value to the owner assessment. As Bonbright says[11];

       "What the appraiser wants is "reasonable" or "justified" or "warranted" value – the amount which the owner should value the property as a wise businessman.

---

9 Bonbright, op cit, at page 15

10 Cf the discussion at paragraphs 61 *et seq* below of Warnike J's views in *Ramsay* – market value is seen as "realistic"; "*Value to the shareholder .... has a strong "notional" aspect, in contrast to the reality of the market.*"

11 Op cit at page 85-86

Similarly, in law, “value to the owner” is rarely if ever identified with the owner’s valuation. …….In legal phraseology, it is the “reasonable “ or “actual” value of the property that is wanted – the value that the property would have in the eyes of a reasonable owner, after he had taken such expert advice as a prudent businessman might be expected to take.”…….

“Reasonable value,” or “value to a reasonable owner,” is, of course, an indefinite concept. ……A valuation involves forecasts of future events, and it also requires that expected events be discounted by reference to risk of nonoccurence and to the interest factor…….The practical impossibility of taking into account individual differences in the assessment of the risk and the interest factors causes appraisers and courts largely to ignore these differences and **accept such discounts for risk and time as have become standardized on [sic.] the market place, or by convention.**” [emphasis added]

b. the valuer thus treats the “owner” as a market participant driven by the same types of considerations as those which affect any investor – return, risk and timing; and

c. the valuer does not speculate upon matters which will materially affect the valuation and depend upon a finding of fact or probability which is disputed and will be dealt with by the court – this is discussed further below.

“Special value”: The IVSC definition

18. In the Family Law context we are generally concerned with the proposition that VTO is more than market value, rather than less. In the definition reproduced at paragraph 11 above, the IVSC2 uses the term “special value” to describe the difference [see paragraph 11 above]:

“Special Value. A term relating to an extraordinary element of value over and above *Market Value. Special value* could arise, for example, by the physical, functional, or economic association of a property with some other property such as the adjoining property. It is an increment of value that could be applicable to a particular owner or user or prospective owner or user, of the property rather than to the market at large; that is, *special value* is applicable only to a purchaser with a special interest. *Marriage value,* the value increment resulting from the merger of two or more interests in a property, represents a specific example of *special value. Special value* could be associated with elements of *going concern value* and with *investment value,* or *worth.* The Valuer must ensure that the criteria used to value such properties are distinguished from those used to estimate *Market Value,* making clear any special assumptions made.”

The definition refers to “property” (real estate) but it is clear that the valuation of businesses is within the scope of the IVCS standards.[12]

19. Getting back to basics the value of any financial asset, no matter what standard of value is applied, must be a function of:

a. the net amount of cash which the owner, or prospective owner, can expect to derive from the holding whether by way of profits (or, more accurately, cash flows generated by profits), sale of the business to another person, or realisation piecemeal of the net assets;

b. the timing of these prospective cash flows; and

c. the riskiness of the cash flows.

12 See generally International Valuation Guidance Note No. 6, Business Valuation

20. It is generally accepted[13] that the discounted cash flow ("**DCF**") approach is the most logically satisfactory valuation methodology[14]. The commonly used capitalisation of maintainable earnings ("**CME**") approach is effectively a "short-form" of the DCF methodology[15]. Both of these rely essentially on a forecast of cash flows and a discount rate. The DCF approach explicitly considers the three elements in the previous paragraph, with the discount rate reflecting the time value of money and risk. The CME approach builds risk, the time value of money, and growth into the capitalisation rate.

21. It follows that, "owner values" can only vary between different persons if :

    a. the expected cash flows are different for persons A and B;

    b. the timing of the cash flows are different; and /or

    c. A and B face different risks. There are two broad aspects to this:

        - A an B perceive risk differently – this may be related, for example, to levels of wealth;

        - A and B may in fact face different risks. For example, the holder of a non-controlling interest in business where the holders have a close relationship and customarily act in concert generally faces less risk than a prospective purchaser of his/her interest.

22. Discounts commonly applied for lack of marketability and lack of control are essentially manifestations of risk attaching to the holding of *interests* in companies or businesses or other assets, rather than whole of the relevant asset.[16]

Common instances where VTO exceeds market value

23. Commonly encountered circumstances where the value to the owner of an asset may be greater than the market value [the amount for which the asset could be sold] are:

    a. where the asset constitutes non-controlling shares in a company in circumstances where the shareholder has a reasonable expectation of obtaining, but not an enforceable legal right to obtain, control, normally on the death of a related controlling shareholder;

    b. where the asset constitutes a non-controlling interest but where the shareholder holds a reasonable and justified expectation, based on a sustained past course of conduct, the shareholders will act in concert so that the benefits springing from the enterprise will be shared in accordance with their ownership interests;

    c. where the asset has synergistic value to the holder ["*marriage value*" in the terminology of the IVSC – see paragraph 18 above] arising from its use in conjunction with some other asset or assets, in circumstances where the synergistic value would not be available to a buyer;

---

13 In the absence of an observable market for dealings in the assets being valued.

14 The DCF approach calculates the present value of a business by discounting future net cash flows (not profits) at a rate commensurate with the risk of the business.

15 When using the CME methodology one seeks to estimate the level of maintainable future earnings/profits likely to be generated by the business being valued, and capitalise those cash flows at a suitable rate [or multiply by an appropriate multiple – the capitalisation multiple is the inverse of the capitalisation rate] that rate being determined mainly by reference to the risks of the investment as compared with alternative investments and allowing for likely growth.

16 Lack of marketability may obviously apply to 100% interests also.

d. where the holder of shares in a company also has a significant loan to the company where there is a risk of default, for example where the loan is unsecured. In such a case the shares are likely to have value to the shareholder greater than the value to an arms length purchaser because the holding of the shares give some element of protection against default. Consider, for example, the situation where the company's liabilities (including an unsecured loan from a controlling shareholder) exceed its assets. On the face of it the shares are worthless, but the shareholder would generally be loath to part with the shares because, once he ceases to have control or influence over the company, the risk of default will increase. Of course, the same factors must be taken into account in valuing the loan and it would be a mistake to double count the same risk or "benefit";

e. similarly, where a holder of controlling shares carrying no, or limited, dividend rights holds other shares carrying discretionary dividend rights, the controlling shares are valuable to the holder because they enable the causation of dividends. In this type of case, the sum of the market values of each of the parcels separately might be significantly less than the market value as one parcel.

f. where a business produces no more than a "fair salary" to the owner but where the owner cannot obtain employment at the rate of remuneration determined to be "fair". In such a case the business is worth more than nothing to the owner, [and perhaps also to others who face the same alternatives]. The deprival value/VTO of such a business may be substantial if the owner faces unemployment as the alternative.

g. other than in the type of case envisaged at (a), where the asset constitutes shares in a company and the holder derives benefits over and above those which could be derived by a prospective purchaser. Examples include:

i a holder of a non-controlling interest exercises, because of his position in the family or some other circumstance relating to the personal relationship between shareholders, significant influence and is able to control dividend policy;

ii a holder of a non-controlling interest exercises, because of his position in the family, significant influence and is able to command a wage in excess of a fair arms length salary. Normally such excess is added back in effecting the valuation. However, that does not fully bring to account the benefits [unless all shareholders take benefits in excess of fair market rates in proportion to their holdings] because only a proportion of the "add back" goes into the calculation of the value of the shareholder's share.

h. Where the income generation depends significantly on the business owner such that the goodwill of the business is personal but the personal goodwill is intertwined with the business.

24. These are all instances of what may be described generally as "special value" How, if at all, they should be taken account of in the Family Law context is considered in Parts I and J below. Before doing that we turn to consider the approach of the Family Court to defining what "value to the owner" means. Again, we are not talking at this stage about a valuation methodology, but rather the valuation objective.

PART C: THE MEANING OF "VALUE TO THE OWNER" IN THE CONTEXT OF FAMILY COURT PROCEEDINGS: THE NON-CONTROLLING SHARE CASES

25. In the Family Court jurisdiction, it may be said, in broad terms, that:

a. that there has developed a school of thought that "value to the owner" is the only standard to be applied, but this is not universally acknowledged;

b. notwithstanding that view, in common practice the standard adopted for valuing assets generally, is market value, sometimes (but perhaps comparatively rarely), on the basis of the express recognition that market value reflects value to the owner;

c. the distinction between market value and value to the owner has been seen in several cases to centre on a consideration of what is "realistic", although that term has not been defined. The use of the word "realistic" perhaps follows the tendency of judges in non Family Law valuation cases to contrast "real" value (in the sense of value to the owner) with market value. However, as we will discuss [see paragraph 61 below and Part D generally], Warnick J in *Ramsay* expressed concern that VTO may not be "realistic" in the literal sense, but was rather "notional" – it is the market which is "real". So, said his Honour, "*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*." [emphasis added].

26. We will explore these issues further. However, I make one observation on the last sentence in the above extract. The "*decision-making process*" is one for the judge, whose ultimate objective in the types of cases we are dealing with, is to divide the property between the parties. The valuation issues are a step in the process but variation in value of an asset may impact relatively little on the ultimate division. Thus, for example in *Turnbull*[17] Baker J decided that non-controlling shares held by the husband in two family companies should be valued [on a VTO basis] at some $4.75 million[18.] The total asset pool was found to be $5 million. The wife was awarded, in essence, $250,000, an amount approximately equal to the whole of the assets, excluding the shares. In effect she received no part of the value of the shares, and indeed it is difficult to see any alternative given that the companies were controlled by the husband's father. The valuation of the share was relevant to determine how much of the remainder of the assets the wife obtained, having regard to the other evidence [including the short period of cohabitation and the "*almost overwhelming*"[19] weight of the Husband's contribution]. If the shares had been found to be "worth" twice or ten times as much, it is unlikely it would have made any difference to the outcome of the case.

27. A further example is the decision of Warnick J himself in *Ramsay* where his Honour first valued the shares, then, taking account of the lack of marketability, reduced the award to the wife from 45% of the pool to 35% - see paragraph 58 below.

What is "Value to the Owner": Family Court "definition"

28. It is fair to say that there is no generally propounded or accepted definition of "value to the owner" in the Family Court context[20]. The Court has often spoken of the objective of arriving at a valuation which is "realistic". Unfortunately, a "realistic" value is one which is seen to reflect value to the owner - the definition is circular [but see the comments of Warnick J described at paragraph 61 below]. The following are examples of the statements made by judges in some of the cases dealing with the valuation of non-controlling interests in companies.

29. In the 1987 decision in *Dunbar* the Full Court of the Family Court appeared to suggest that the "willing buyer, willing seller" approach was universally to be applied[21]:

---

17 *Turnbull and Turnbull; Turnbull JR, Bald Hills Pty Limited, Allans Waters Pty Limited and Apropos Pty Limited* (1991) FLC 92-258; [see paragraph 41]

18 There does not appear to be an explicit finding about market value.

19 At p78,740

20 This lack of definition is not restricted to the Family Court but bedevils many areas of litigation where the Court looks to ascertain "real value", on the basis that market value (if there is one) is not the appropriate measure for the Court's purposes.

21 *Dunbar and Dunbar* (1987) FLC ¶91-846 at p76,399. The case concerned the valuation of an interest in a partnership, rather than shares, but the extract quoted appears to have been intended to be of general application.

"The object of any valuation exercise is to establish what a willing but not anxious purchaser would be prepare to pay and a willing but not anxious seller would be prepare to accept (see *Spencer v. The Commonwealth of Australia* (1907) 5 C.L.R. 418)."

In a line of decisions, commencing with *Hull* the Family Court came to modify that approach.

Hull (1983)[22]

30. In *Hull* the Wife held 100 B class shares and 19,800 C class shares in Jell Property Co Pty Limited. The only other issued shares were 100 A class shares held by the Wife's mother, Mrs D. Only the A class shares carried voting rights. The shares ranked equally as regards "capital rights", which it appears (although it is not explicitly stated in the judgement) included dividend rights. There had not been any payment of dividends in recent years. Nygh J put the position thus:

"The upshot is that Mrs D holds all the effective power and control over the company and Mrs Hull has the virtually all of the equity interest subject to the power of Mrs D. in the exercise of her voting rights to increase the capital of the company and alter the present balance of shareholding. There is, however, no evidence that Mrs D is likely to do so in the foreseeable future."

31. The valuer for the Husband proposed a value of the shares on an asset backing basis, yielding a value (allowing for a valuation of underlying real estate) of some $267,000[23.] The Wife's valuer valued the shares on what is described in the judgement as an "earnings" basis but appears to have been a dividend yield basis. His Honour said [at page 78,409] describing the Wife's valuers approach "*since …..the earnings of Mrs Hull's shares have been nil, so should the value of the shares*".

32. Counsel for the Wife relied on the decision of the High Court in *St Helens Farm*[24], where the majority had held that the normal practice of valuing shares in a company which was a going concern on an earnings basis should be followed in that case. However, his Honour noted that "*the High Court acknowledged that this principle was subject to exceptions, one of those exceptions being where a company's operations do not produce income which can be regarded as affording any measure of the value of the shares".* Nygh J was satisfied that *"The latter is true in the present case.*"[25]. However, said his Honour, this was not the end of the problem. It remained to deal with the submission on behalf of the Wife that the basis of valuation should be that propounded in *Spencer* (ie the willing buyer, willing seller test). The directors could decline a transfer without giving reasons and the purchaser would have to consider that the mother would remain in control of the company and might assign her shares to a third party "*thereby depriving [the purchaser of the Wife's shares] of effective control*". In the light of these factors his Honour agreed that the current value of the shares on the market would be nil.[26].

33. However, his Honour thought it "artificial" to adopt such a basis of valuation:

---

22 *Hull and Hull* (1983) FLC 91-360 9 Fam LR 241; see also the decision by the same judge, Nygh J, in *Bowman and Bowman* (1984) FLC 91-574; (1984) 9 Fam. L.R. 619.

23 Being $272,000 net asset value of the company times 19,900/20,000 shares – that is, without any discount for lack of control or marketability.

24 *Federal Commissioner of Taxation v St Helen's Farm (A.C.T.) Ltd & Ors* 81 ATC 4040.

25 His Honour said: "*Due to the use of tax losses the company is managed in such a way so as not to produce a taxable income*". It seems odd, with respect, to speak of the utilisation of tax losses as a "management" function. In any event, a valuation based on earnings looks at profits – the availability of tax losses does not mean no profits are generated. The company was in fact profitable. While the availability of losses means that the company may not have been obliged to pay dividends to avoid Div 7 tax, it appears that the High Court in *St Helens Farm* was talking about company *profits* and not taxable income or dividends.

26 At page 78,410.

"However, it is in my view artificial to adopt such a basis of valuation in relation to interests in private companies. It cannot be said in all seriousness that Mrs Hull's interest in the company is valueless**. The test laid down in *Spencer's case* …can only be applied where there is a ready and available market. It is of no application in a case such as this where such as this where such a market is lacking.**

This Court must approach a question of valuation **on a realistic basis** and as the a High Court accepted in *St Helen's Farm* case…… the question of valuation is essentially a matter for the trial Judge. As the Full Court said in *Antmann* and *Antmann* (1980) FLC ¶90-908, there is no fixed rule as to what is the proper method of valuation which depends not only on the type of property or commodity concerned, but also on the purpose for which the goods were originally acquired and the need to realise on them in the shorter or longer term[27].

The situation is not unlike the one which prevailed in *W*. and *W*. ….., where the wife was the owner of a grazing property which was in the effective control of her father during his lifetime and from which she derived only very limited financial benefits….

In this case I cannot shut my eyes to the fact that **the scheme embodied in the Articles of Association of the company is clearly designed to give the wife eventual control over the property**. Taking the approach I took in W. and W. …..I therefore find that the wife has an asset of a value of approximately $267,000. However, since that asset is not realisable by her in the foreseeable future, I will take it into account only as regards the question of her future needs….." [bolding added]

34. Nygh J did not use the term "value to the owner" or allude to that concept. His Honour said that "[*the] test laid down in Spencer's Case … can only be applied where there is a ready and available market*". His Honour did not explicitly comment upon the fact that in *Spencer* there was no market. The willing buyer, willing seller "basis" was not appropriate because "**in all seriousness**" it could not be said that Mrs Hull's interest in the company is valueless. Why it necessarily followed that a net assets basis was appropriate is not explained in terms of any "theory" or standard of value. Again, note that the value fixed by his Honour was *"[taken] into account only as regards the question of her future needs*".

Reynolds (1984)[28]

35. Reynolds again dealt with a non-controlling interest held by a son/husband. At first instance Ferrier J held that:

"The [Husband's] shareholding has a present value of at least $171,211.07[29], even though it is highly unlikely that presently it could be realised in that sum or any sum at all by reason of the control of the husband's parents as directors of the company. I think that the only realistic way of looking at ... [the husband's] shareholding in the company is in terms of a financial resource of indefinable but substantial value available to him through, but subject to, the dynastic control of his parents while they live."

36. On appeal the Full Court proffered the much quoted qualification to the "commercial" approach to valuing shares in private companies[30]:

---

27 It may be noted that the Full Court in *Antmann* made these observations in the context of dealing with the wife's assertion that the trial judge should have valued certain jewellery at its realisable value rather than replacement price. It is difficult to see, with respect, how the method of valuation can depend on the purpose of *acquisition* of the goods unless by that is meant the intention to sell or not to sell at the date of valuation.

28 *Reynolds and Reynolds* (1985) 1-632; (1984) 10 FamLR 388, at page 80,111.

29 This appears to have been the amount realisable on a winding up – see at page 80,109. The description "present value" is perhaps not ideal.

30 At page 80,111.

"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 or capital value of shares in a proprietary company may not reflect their value to a 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.

If there were a winding up of the company the husband might then realise the value set on them by his honour. *The reality of the situation is, however, that a winding up is not in the least likely and the shares do not appear to have a commercial value so as to enable the husband to sell them and pay the wife the sum ordered.*

That they are of value to the husband in the future is not in doubt but of how much value was impossible for His Honour to determine. It is a question, inter alia, of how much his Honour regarded that factor and how much weight he gave to it.'" [italics added]

Sapir (1989) [31]

37. In *Sapir* the wife held a 48% interest in several family companies. The rights attaching to the shares were subordinate to those attaching to shares held by her parents who had successive governing directorship rights. Two chartered accountants gave evidence as to the value of the wife's shares. Each used essentially the same figures. However, the valuer called for the wife applied a discount rate of 12-16%, yielding a value for the shares in the range of $373-$548,000. The valuer called for the husband applied a discount rate of 4-6% to arrive at a value in the range of $998,000 - $1,228,000. Young J commented on the disparity in the following terms[32]:

"The discount rate in each case was 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 still alive."

"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." [bolding added]

38. His Honour posed for himself the question[33]:

"Does the Court then need to determine the value of the shares to the wife or the value of the shares in the hands of a hypothetical willing seller or a hypothetical willing buyer."

After reviewing the decisions in *Mallet*, *Gipps*, *Reynolds*, *Hull* and *Bowman* his Honour concluded[34]:

---

31 *Sapir v Sapir (No. 2)* (1989) 13 FamLR 361; (1989) FLC 92-047. The case was decided in the New South Wales Supreme Court rather than the Family Court of Australia, in accordance with Commonwealth cross-vesting legislation

32 At 77,542.

33 At p.77,543

34 At p.77,543

"In my view, the Supreme Court when trying a Family Law case pursuant to the Commonwealth Cross Vesting legislation, should, as closely as possible, follow the same course as if that proceeding had taken place before the usual Court, such proceedings. Thus, it seems to me that I should, in this case, follow the precedents set by the Family Court even though technically speaking, they may not be binding upon this court. Accordingly, in my *view I should adopt the basis of valuation put by the Husband's valuer, that is, the value of the shares to the wife, not their commercial value or their value to a hypothetical purchaser*." [italics added].

39. Having determined that[35] *"… it would appear that provided that the wife outlives both her parents, the probability is that she will inherit the parents' interests in the shares …*", his Honour proceeded to adjust the value fixed by the accountant called for the husband by increasing somewhat the discount rate to 6.5% to allow for "**too many unjustified assumptions**" producing a value of some $948,000. That amount was included in the value of the property held by the wife. Although it is not explicit in the judgment it appears that the calculations of value referred to in the judgment were effected as follows:

Asset backing of wife's shares[36]			$1,881,732
Present value calculated by discounting that amount for 10.89 years[37] at:			
Husband's valuer :	4% per annum		$1,227,623
	:	6% per annum	$997,648
Wife's valuer	:	12% per annum	$547,739
	:	16% per annum	$373,775
Young J	:	6.5%	$947,800

40. The "discounted future value" approach was applied subsequently in *Georgeson* [see paragraph 44 below].

Turnbull (1991)[38]

41. In *Turnbull* the husband held interests in two private companies controlled by his father. The valuer called for the wife argued that the husband's shares should be valued at 80% of their net asset backing: a 20% discount should be applied, he said, because of the rights of control held by the father. The accountant for the wife valued the shares on the basis of a willing buyer, willing seller approach, yielding a very low value. Baker J rejected both approaches finding values as follows:

35 At p77,544.
36 By extrapolation from other figures.
37 See at p77,544.
38 *Turnbull and Turnbull, Turnbull JR, Bald Hills Pty Limited, Allans Waters Pty Limited and Apropos Pty Limited* (1991) 15 FamLR 81; (1991) FLC 92-258

	Allens Waters P.L.	**Bald Hills P.L**[39]
Net assets ($M)	4.565	1.758
Shareholders[40] :		
Father (6% non-cumulative prefs)	1	1
Mother	1	1
Husband (ordinary)	2,000	2,000
Each of four sisters (ordinary)	-	2,000
Pro-rata value per share ($M)	4.565	0.3516
Valuation by wife's valuer (less 20%)	3.652	0.2813
Discount by Court	5%	10%
Valuation by Court ($M)	4.337	0.3165

42. After reviewing the decisions in *Hull, Reynolds* and *Sapir*, his Honour concluded[41]:

"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.

....

I am firmly of the view that a modest *discount rate* should be applied to the value of the husband's shares in each company. In the case of Allans Water Pty Limited, I am satisfied that the father's ultimate intention is for "Bald Hills" to effectively remain in the husband's ownership, whether by way of an equity shareholding or as a beneficiary of the trust. I would therefore adopt a *discount rate* of 5 per cent, which places a value of the husband's shares in the company ... of $4.337 million.

In relation to Bald Hills Pty Limited the husband has a one-fifth equity shareholding in that company and, in view of the fact that he has four sisters with whom the husband will ultimately have to deal, I would adopt a *discount rate* of 10 percent. I therefore find the value of the husband's shareholding in Bald Hills Pty Limited to be $316,498." [*italics added*]

43. The "discount rates" referred to in the above extracts are percentage deductions from the proportionate net worth of the relevant companies. That is, they are not capitalisation rates applied to earnings or discount rates applied to earnings or cash flow projections. As already stated, his Honour had reviewed the decisions in *Hull*, *Reynolds* and *Sapir*. In the first two cases, the Court "took into account" the full rateable value of the shares, although relevant amounts were not included in the asset pool available for division. In *Sapir*, Young J had applied a discounting process [see paragraph 40 above] but it is not explicitly stated in the judgement that annual discounting is applied, rather than a mere "flat" reduction from the rateable value. It may thus be that Baker J had misunderstood the calculation in *Sapir*. Certainly, on the face of it, it is difficult to see how, on any view, the value of shares to the husband

---

39 The children had different classes of ordinary shares in Bald Hills Pty Limited.

40 An allotment of shares to a trust for the benefit of the husband and his children and grandchildren were set aside pursuant to sec 85 of the Family Law Act, notwithstanding that it was found to be a valid exercise of the powers of the father. The effect of the allotment had been that "*the husband's 100% equity shareholding in the company was reduced to a shareholding equivalent to 3.8 per cent of the issued equity capital.*" [at p78,734].

41 P78,738

could be as high as Baker J had determined [even the expert for the Wife thought the lack of control called for a larger discount]. On the other hand, one must have some regard to the overall outcome of the case in forming a view as to the practical significance of the valuations adopted by his Honour. The effect of the orders made was that an amount equal to the value of the bulk of the assets actually controlled by the Husband (except the shares) was effectively given to the Wife[42]. The Husband was not ordered to try to realise his share interests[43].

Georgeson (1995) [44]:

44. In *Georgeson* the wife was the beneficial owner of 625 ordinary shares in a company ("MGVI") involved in property ownership and investment. The directors were the wife's parents and her sister. The wife's father controlled the company by virtue of the holding of one "A" class redeemable preference share. The wife's mother held one "B" class redeemable preference share and one of the wife's sisters one "C" class redeemable preference share. The wife's parents held 625 ordinary shares in trust for each of the wife and her three sisters. The company had not paid a dividend for the last four years.

45. It was agreed that the proportionate "interest" of the wife in the net tangible assets of the company was $1,070,000. The accountant called for the husband valued the shares at $909,500 calculated by reducing the figure of $1,070,000 by 15%. The accountant for the wife calculated the value at $365,940 using the discounted cash flow method applying a discount rate of 5%[45]. This was the approach which had been adopted in *Sapir* (supra).

46. The trial judge concluded:

"In my view the task is to ascertain the **real present value** of the shares. The reality of the situation in this matter is that the wife is an employee of the company and has never had any position of management and has never played and there is no evidence that she is likely to play any role in the management of the company. The wife will not step into the shoes of her parents in relation to the control of the company. The wife's continued involvement is not essential for the good of the shareholders. The wife has had the benefit of dividends which have been credited to a loan account in her name with the company and also interest in the loan account. The wife has been able to draw money from the loan account from time to time for her own benefit but she has no ability to determine or influence whether dividends or interest are paid. The wife's evidence made it very clear that her father is in control of the company and he makes decisions in relation to the affairs of the company (and for that matter the personal financial affairs of the wife) of which not only does the wife play no part but in some instances she has no notice of [at pp 82215-6].

---

42 The total net asset pool was found to $5.001 million of which the wife held property valued at $10,601 and the husband's shares in the two family companies were worth $4.653 million. The husband was ordered to pay the wife $114,399 ($125,000 less $10,601) in respect of the wife's contribution and $150,000 in respect of her maintenance, and child maintenance of $120 per week :at pp 78,740-1. The order to pay a total of $264,399 by way of property settlement may be compared to the total value of assets held by the husband (excluding the family company shares) of some $338,000.

43 Such an order would seemingly have given rise to considerable practical difficulties simply because the value of the shares to any third party other than, perhaps, the Father (in the case of Allans Water), or the sisters or the father (in the case of Bald Hills), would have been considerably less than the "value to the Husband" as measured by his Honour. That being said, the fact that the court knows that a party does not have sufficient funds to meet property orders may not prevent the making of the orders if the court can assume that the party's family will assist – see, eg, *Turnbull* and *Reynolds*.

44 *Georgeson and Georgeson* (1995) FLC 92-618. see at pp 82,215-6.

45 ".. the present value of $1 using a 5% per annum discount rate over 22 years is 0.342. .... Under this method the present value to the wife's entitlement to one quarter of the surplus assets of the company, discounted at 5%, is $1,070,000 x 0.342 = $365,940."

....
I do not accept that the reality is that the shares have a real present value of a figure which represents only a 15% discount of the present full proportional value. The wife is in a position where she could not obtain the benefit of the full proportional value for at least 22 years and perhaps longer. ... ultimately control flows to the wife's sister, who is younger than the wife and the wife may get no value even when her sister assumes control. The rate chosen by [the accountant for the wife] takes into account risk, lack of negotiability and lack of control. In my view no one would give the wife $900,000 for her shares and there are no benefits received or receivable by the wife which could justify such a high current value in the hands of the wife. Further**, what benefits the wife has received such as interest on a loan account and drawings have not, in my view, been as a result of the shareholding**. ……….. Wayne Lonergan said that the valuation of minority interests in profitable companies which have not paid a dividend in recent years should be assessed as the present value of the eventual return such shares might offer to a prospective purchaser. In my view [the accountant for the wife] has realistically sought to provide a real current value on the shares of the wife. [The accountant for the husband] has failed, in my view to provide any or any cogent reasons why he chose the discount rate of 15%. ………….. In my view the value of [the accountant for the wife] is to be preferred." [at p82,216] (bolding added)

47. An appeal to the Full Court of the Family Court[46] was dismissed. The Full Court commented[47:]

"The approach of [the husband's valuer] is an approach commonly used to ascertain the value of shares in Family Court proceedings. He applied a flat discount rate of 15 per cent to the figure of $1,070,000, being the agreed proportionate interest of the wife. In our view, in the circumstances of this case, such a discount rate is far too low and was not adequately supported…. When one has regard to the significant disadvantages attaching to the shares of the wife referred to by both accountants and to the probability that there is not and never will be an open market for those shares, considerable support is provided for the application of a substantial discount well above the 15 per cent….Indeed, in our view, an approximate discount rate of 65 per cent would be more appropriate, That was the flat discount rate against the current value of the shares used by [the wife's valuer] as a check on the result of his preferred methodology."

Harrison (1996)[48] at first instance:

48. In *Harrison* the assets of the husband included 14% of the shares in Company A and 20% of the shares in Company B. Both were "family companies". The husband was employed by company A; it appears that the remaining shares were held by other family members. It is not clear from the report who, if anyone controlled the companies. The trial judge accepted the evidence of the other family members that they would not approve a transfer to a third party and their denial that they could or would purchase the husband's shares. The accountant for the husband valued the holdings based on a pro-rata value discounted for "lack of control" by 10% and 5% respectively. The lower rate was applied because of the higher holding in Company B and because that company was an "investment vehicle". The wife's accountant contended that no discount should be applied because the family would want to retain 100% of the shares and would be willing to pay "a fair price" for them. The accountants agreed that discounts for lack of control would generally be in the range of 10% to 25%.[49]

46 (1995) FLC 92-618

47 At p82,219

48 *Harrison and Harrison* (Unreported. No ML5938 of 1994, Brown J, 17 November 1995)

49 It appears from the judgment that the experts were talking about discounts applicable where third parties (rather than existing shareholders who were family members) acquired the shares, but this is not entirely clear.

49. At first instance the Court accepted the valuation of the husband's accountant. The husband appealed on the basis, inter alia, that, although the shares could be "artificially valued" they should not be included in the pool of assets available for distribution - they were "valueless because unrealisable". On that point the trial judge had held[50]:

"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 toward payment of certain household bills and the flexibility of being, if not self-employed, employed by a company in which he is 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. In all the circumstances of this case I reject the submission that the husband's shareholding in both companies should not be included in the pool of assets." [bolding added]

50. How the trial judge saw the “benefit” of being “quasi self-employed” as relating to the shareholding is not entirely clear. In any event, on appeal[51] the Full Court of the Family Court agreed with the outcome:

“In our opinion, the trial Judge correctly interpreted that the law as it stands in relation to the value to be placed upon interest in family companies. Revenue and taxation cases ... have little relevance to the value which a Court, exercising jurisdiction under the Family Law Act, places upon such interests. The value to be ascribed to shares in a family company must be **a realistic one, based upon the worth of the shares to the party** himself or herself. That was clearly the approach which the trial Judge took, and therefore no error, in our opinion can be demonstrated.” [bolding added].

Taylor[52] (1999)

51. The Full Court of the Family Court said:

24.6 Whilst **the primary test is that of a hypothetical prudent purchaser** (*Gamer and Gamer* (1988) FLC91-932 at 76,743), it is the case that for the purposes of Family Law, “… the present commercial or 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” (*Reynolds and Reynolds* (1985) FLC 91-632 at 80,111).

24.7 In proceedings under the Family Law Act, “… the value to be ascribed to shares in a family Company **must be a realistic one, based upon the worth of the shares to the party himself or herself**” (*Harrison and Harrison* (1996) FLC 92-682 at 83,087; see also *Turnbull and Turnbull and Others* (1991) FLC 92-258 at 78,738).” [bolding added]

---

50 Appeal judgement at p83,087

51 *Harrison and Harrison* (1996) FLC 92-682

52 Unreported, NA54 of 1999, Full Court of the Family Court (Finn, Kay and Barlow JJ), 11 April 2000. The cases dealt with the value of the husband’s shares in a company, comprising 15.8% of the ordinary shares and 28.9% of the C class shares. The remaining ordinary shares were held as to 15.8% by each of the two brothers and 52.4% by their father. The remaining C class shares were also held by the brother and father. The trial judge found that the husband and his brothers each had 23.19% of the shares entitled to participate in capital distributions on a winding up but that control rested with the father.

52. The statement "*the primary test is that of a hypothetical prudent purchaser*" appears to sit uncomfortably with what follows in the above extract, unless the Court meant that a value to the owner standard applies only to shares in family companies. But that is inconsistent with the cases discussed below.

PART D: IF VTO MEANS "REALISTIC", WHAT DOES "REALISTIC" MEAN?

Ramsay (1997)[53]

53. A significant development in the exposition of what at least one judge thought the valuer is supposed to be doing is the decision of Warnick J in *Ramsay*. In that case the central issue was the value of the husband's shares in Pindara Securities Pty Ltd. The issued capital was held as to 12,500 ordinary shares by each of the husband, his sister, their father and their mother, and 5,000 "A" ordinary shares by Bergenia Pty Ltd. The two voting shares in Bergenia were held as to one by each of the mother and the father, and the other (non-voting) shares by various trust entities. Since 1987, all dividend distributions by Pindara, with one small exception, had been made to Bergenia, which then determined the distributions to the family trusts. At the date of valuation of the shareholding Pindara held (through a wholly owned subsidiary) investments comprising, for the most part, listed shares and real estate.

54. The valuer for the wife valued the shareholding on a net asset backing basis because:

   a. the company was an investment company holding substantial real estate and publicly listed shares;

   b. of the family relationship - in particular, the two elderly parents currently holding control of the entity; and

   c. some of the assets of the Company were not income-earning.

   It appears that the valuer had assumed that there was a very real prospect of the Husband achieving control of the entity in the future. In his oral evidence the valuer agreed that his valuation would require to be discounted by about 10% if the Husband *"were not to be seen as likely to achieve control"*.

55. The valuer for the husband valued the husband's shareholding on two bases:

   a. at "nil" because the husband could not realistically sell to a stranger and there was no indication of any interest in purchase by other shareholders;

   b. alternatively, at $1.345 million, being the value of the income stream determined by capitalising[54] the income historically received by the husband from a variety of sources, including salary, fringe benefits such as motor vehicle and housing benefit, and distributions from related trusts[55].

56. The valuer's reasons for the adoption of the alternative method, which ignored the group structure, were:

   a. the lack of control of the husband over the Ramsay Group due to his minority holdings [sic];

   b. the history of distributions from Pindara and Bergenia;

   c. since 1987 all available profits of the group have been distributed to family members;

   d. the husband has no intention of selling his interests in the group; and

---

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

54 The rate is not disclosed and it is not possible to know what allowance, if any, was made for lack of control or marketability.

55 No details of the break up of these amounts is provided.

e. the understanding that Pindara would continue to pay out its profits by way of dividends to its shareholders.

It appears that the valuation of $1.345 million represented a significant discount (approximately 55%) on the net asset backing of the shareholding.

57. The Court rejected the assumption on which the valuation for the wife was based finding that "...*all of the evidence about the intention of the husband's parents indicates that the husband could hold no reasonable expectation of gaining control of Pindara*". He concluded that the Wife's valuer had *"failed to consider the importance of his* [incorrect] *assumption in the selection of the very methodology utilised by him"*.

58. After reviewing several of the leading Family Law cases in which minority shareholdings in family companies were required to be valued, Warwick J concluded that value to owner rather than market value was the appropriate concept for the valuation of the shareholding. His Honour accordingly accepted the valuation of $1.345 million – the alternative valuation on behalf of the Husband - but, *"to recognise that the value to the Husband of his shareholding is not realisable in the value found or at any particular value",* his Honour reduced[56] the Wife's share in the division of the Husband's assets (including the shareholding) from 45% (the percentage which he would otherwise have allowed) to 35% - a diminution of $151,480. In effect, then, there was a discount for non-negotiability of 25% applied to the shares as follows:

	Actual	**If realisable**	**Difference**	**Notional Reduction**	**Notional Value**
Total available assets:					
Shares	1,345,000	1,345,000		336,623	1,008,377
Other assets	169,804	169,804			169,804
	1,514,804	1,514,804			1,178,181
Proportion to wife	35%	45%			45%
Amount to wife	530,181	681,662	151,480	*A*	530,181
Wife's notional interest			45%	*B*	
Effective discounting of shares			336,623	*C = A/B*	
Base value			1,345,000	*D*	
Implicit percentage reduction			25%	*E = C/D*	

Of course, it could not be said that that establishes any general principle – see paragraph 4 above. In any event, the extent of the "discount" in effect depended upon the quantum of other disposable assets and the overall content of the orders.

59. Perhaps the most unusual feature of the valuation is that the value of the shareholding is calculated by reference to the income of the husband from the Ramsay Group – not by reference to dividend income (virtually nil) derived from the shareholding itself. The Court expressly endorsed the decision of the husband's valuer to ignore the group structure in valuing the shareholding. It is of interest to note that the income capitalised in the determination of the value of the shareholding included:

56 See at page 84,004

a. salary and fringe benefits such as motor vehicle and housing benefits which would usually be considered as a reward for services, not as a return on an investment. It would seem that these items of income would have been derived whether or not the shares were held. The share value appears to have embodied a substantial component of the husband's personal earning capacity. The fact that he might not have been employed by the group had he not been the son of the controlling shareholders (which relationship gave rise also to shareholding) did not mean, it is submitted, that the salary income flowed from the shareholding; and

b. distributions from discretionary trusts apparently not controlled by the Husband. The entitlement to such income would appear to spring from the exercise of a direction by the trustee, not from the shareholding.

60. His Honour made some, with respect, helpful observations about the significance of the use if the term "realistic " in earlier cases in conjunction with the adoption of the term "value to the owner". His Honour first set out what the overall objective should be:

"Not only has it been recognized in many of the cases later cited that (as was recognised in *Mallet* (supra)), the purpose of valuation identified for Family Court cases differs from that in revenue and taxation cases, but it has also been recognised that the approaches developed for those cases may well be inappropriate for Family Court purposes. It may be however that, as earlier stated, there has been insufficient identification, both by the accountancy profession and by the Courts, of the approaches which are appropriate for Family Court purposes.

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)."

61. Warnick J then turned to the question of what courts in earlier judgements had meant by the word "realistic":

"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." (bolding added)

62. There can be no doubt that, with respect, that there is an "area of tension". However, in this author's view, it seems reasonably clear that, in the earlier decisions [to use his Honour's words] "*the use of the term "realistic"[was] seen as simply "shorthand" for the expression "value to the shareholder*"". The market was seen to give an "unrealistic" measure of value for the purposes of application of the Family Law Act. [Cf Nygh J in Hull [paragraph 33 above]: "*It cannot be said in all*

seriousness that Mrs Hull's interest in the company is valueless".] It is important, in this author's view, not to see the words of Warnike J as suggesting that the Courts had meant something else.

63. Neither should be seen that "value to the owner" is, or may be, "unrealistic", *merely* because it does not reflect market value. Rather, the Court sees that there is no market, or no market which will properly measure value to the owner, and so ignores the market. The fact that the asset cannot be sold to realise the value to the owner does not mean that the asset has no "value". The problem comes back to defining what "value to the owner" means. Of course, one can't help but agree with his Honour that taking "*account of a number of assumptions about the receipt of benefits*" may be fraught with difficulties, but that is a matter of application of valuation methodology. It does not invalidate the objective. It is submitted that the objective is to distinguish the value of personal earning capacity from the value of cash flows which emanate from the holding of an asset being, in the cases we are now discussing, a share or parcel of shares. The future "earning capacity" [in the personal exertion sense] of the parties should be dealt with separately. The distinction is clear in cases where the husband/wife is not involved in the relevant company's activities, but becomes blurred where the party is an employee or obtains ancillary benefits not being dividends or an eventual interest on succession. Warnick J has clarified this issue further in *AJW and JMW* (see paragraph 79 below).

64. Another concern with the above passage is the use of the words' "*value to the shareholder…….often takes account of a number of assumptions about the receipt of benefits (often not attaching to the shareholding "per se")".* Although the word "attaching" is not explained, it is submitted that the value of shares should not include "*the receipt of benefits … not attaching to the shareholding "per se*"". These benefits should be treated separately, with particular care not to include as "property" the capitalisation of earning capacity (see the discussion of *Wall* in Part G). If value to the owner is measured in terms of the present value of future benefits, on the basis of reasonable expectations, then it is no different from the way market value is measured. It is just that the asset cannot be alienated for that value. It is submitted that there is nothing "unreal" about that.

65. His Honour proffered some suggestions as to the approach which experts might take[57]:

"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;

57 At p 83,999

(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." [**emphasis added**].

66. With respect, this is useful framework for the valuer. Some comments:

a. it is not clear whether his Honour was saying at paragraph (c) that no discount should be applied for lack of marketability even in cases where there is a market. Valuers commonly apply discounts for lack of marketability in valuing, for example, minority interests which are in fact marketable, but not readily. In the author's opinion the valuer shall express an opinion about the impact of lack of marketability in this sense.

b. as to (e) it is not clear if his Honour meant to convey by the words "*if he/she gains control*" the idea "the present value *on the assumption that* the party will gain control"; the word "if" implies a future value. For an expert to estimate a future value without any discounting might lead to considerable confusion, although no doubt it is useful for the Court to know what the future value is seen by the expert to be. However, it appears that his Honour is saying that no allowance should be made in the discount rate, or otherwise, for any uncertainty as to whether or not control will actually be obtained. The valuer shall simply show the (present) value on the assumption that control will be obtained, and on the assumption that it will not, and leave the rest to the court;

As his Honour makes clear, these are "observations". They don't represent "the law of valuation". However, in my view, again with respect, they are useful signposts to the role of the valuer.

Barouche (1999)[58]

67. In *Barouche*, the wife held shares in two companies, E and K. The wife and her mother were the only directors of both companies. The latter company did not trade; its only assets were shares in, and a loan to, a related company. The book value of the K companies' net assets was some $3.5 million. The assets of E were bonds, shares and a loan (to the wife's mother), with a value totalling some $1.7 million before any capital gains tax on revaluation.

68. In valuing the wife's shares, the husband's valuer took the pro rated net asset figure and applied a discount of 5% in the case of E and 20% in the case of K "to reflect lack of control". The wife's valuer valued the wife's shares by reference to capitalisation of maintainable dividends. The following table summarises what appears[59] to be basis of the valuations of the E shares. The dividend valuation by the husband's valuer was effected as part of the Order 30A process and was not his preferred basis. It assumed no retention and a yield based on the return actually obtained by the company on its investments, therefore giving a value to the share (before a control discount) equal to the pro rata asset backing:

58 *Barouche and Barouche*, Unreported. No. SY 4001 of 1999, Moore J

59 The valuations are not reproduced in the judgment. The figures shown are extrapolated from the various comments made by her Honour. It does not appear possible to reconcile the various data with regard to the K shares, but the approach taken by the valuers and the Court was the same

		Wife's valuer	Husband's valuer
Maintainable post tax earnings		$70,000	$70,000
Retention		10%	0
Dividend	A	63,000	70,000
No of shares held by Wife		100 / 300	100 / 300
Dividend on Wife's shares		21,000	23,333
Dividend yield		6%	4.016%
Capitalised dividend		350,000	580,979
Marketability/minority discount		55%	5%
Value of Wife's shares		**$157,500**	$551,938
Net tangible assets	B		1,742,963
Pro rata share			580,988
Lack of control discount			5%
Value of Wife's shares			**$551,938**
Income / net assets	A / B		4.016%

69. Moore J. accepted the methodology of the wife's valuer as appropriate, holding that[60:]

"[the task of the husband's valuer] was not as he stated it … to value an investment entity. His task was to value the minority interest of a shareholder in a private company"

Her Honour found that the husband's valuer had no authority for the "flat discount" method he used. As to the earlier decisions of the Family Court, her Honour said[61:]

"… to the extent that [the husband's valuer] relied upon an approach to cases in this Court as justifying his selection of method, for the reason that he considered it to give a more "realistic" valuation, it was untenable. Any item of "special value" … by reason of additional benefits or the particular context of the holder are for this Court to decide, having regard to the evidence, assuming of course that these benefits attach to the shares and are not the result of some other context of the holder. At any rate, there has not been demonstrated any special benefit to the wife by reason of her shareholdings in [E] and [K] in my view."

70. Having concluded that dividend capitalisation was the appropriate method, her Honour rejected the approach of the husband's valuer on the basis that the dividend yield (and implied price earnings ratio) "*do not sit comfortably with those available in the public listed sector*", and[62]:

"In any case….the assets of an enterprise and the book value or market value of those assets , while they may be crucial in some circumstances and certainly will be where the notional liquidation method is appropriate, have little relevance in valuing a minority interest shareholding."

60 At p32, para 98
61 At p33, para 100
62 At p35, para 107

71. In arriving at her conclusions Moore J appears to have rejected a value to the owner basis because she saw that approach as only relevant where there arose some “special benefit” to the relevant shareholder. At pages 23-4 [paras 73-75] appears the following passage:

“[The value to the holder concept] has been referred to in a string of cases; for example [*Hull*, *Reynolds*, *Sapir*, *Turnbull*, *Georgeson* and *Harrison*]. The discussions have usually been in the context of valuing shares in private companies and the common thread running through then seems to be agreement that the task of the Court in S. 79 proceedings is to value the shares on the basis of their worth to the holder; that must be a ‘*realistic*’ one by looking to the holder’s circumstances, usually within the context of their family as a whole; and this approach is to be taken as distinct from, say, their ‘*commercial*’ value or their ‘*value to a hypothetical purchaser*’.

As I read the discussions, this arises from the need to address any real or even additional benefits available to the particular holder conferred by their ownership of the shares, not otherwise brought to account if the question of their value were to be considered outside the context of property proceedings. An example of this can be seen from the observations of the trial judge, approved by the Full Court, in *Harrison…*..

The goal to be achieved, then, would seem to be agreed. But what seems to need further discussion is how that is to be approached and the role of the experts in achieving it.”

72. Moore J warned against seeing the adoption of a value to the owner approach as an invitation to abandon valuation principles [at para 77]:

“But the ascertainment of the value to the holder is not necessarily as I see it at least, about selection of methodology. That is to say, it is not an invitation to abandon principled methodology selected … by reason of known facts related to a particular enterprise and shareholding. Adherence to sound valuation principles, demonstrating a logical and methodical approach and accompanied by the application of sound judgment for variables, is no less required because the valuation exercise is being conducted under the canopy of proceedings in this Court.”

73. Her Honour went on to outline the expert’s role in achieving “the goal”. In the light of that discussion, and having regard to what is said above and elsewhere in the judgment, it is evident that her Honour was satisfied that the “value to the owner concept” was only relevant to try to capture the worth to the owner of “additional benefits” which would not be available to a prospective buyer. The critical issue then was what “benefits”, if any, existed.

74. Moore J outlined the difficulties which arise when valuers adopt different “facts” [paras 79-83]:

“(79) Yet it seems to me a problem can develop when, throughout the exercise they have undertaken, either in the selection of method or in the adjustments or variables they apply, valuers take on disputed or contentious facts and base their opinion on them as if they were beyond controversy. This confuses the task for the Court to make findings of disputed fact and the task of the valuers to express opinions within their expertise based on facts they have made apparent.

(80) If there are disputed facts or uncertainties about various matters, either effecting selection of methodology or variables to be applied, it would be **more helpful and likely to reduce the time taken at the hearing cross-examining them about it, if the valuers were to express first their opinion on what is known or accepted. Then, having identified the contentious facts and recorded their assumptions about them, they were to express their opinion on that basis**. Depending on the outcome of the fact finding process at the end of the day, the Court would then have a range to consider and be better positioned to take the experts’ evidence into account in arriving at a conclusion about value.

(81) To give a simple example to illustrate the point. A party may have a minority holding. But there is a contention about whether that holder will gain control after the proceedings, for reasons too varied to speculate about here. One valuer looks to the current minority holding and adopts a capitalisation of dividends approach. The other not only adopts another approach but makes no discount for a minority interest. The basis on which that rests is an assumption that control is/will be in the holder's hands. The presentation of these polar positions represents a stark choice for the Court's consideration in coming to its' own view about value. What they have each done is take on board the fact-finding process, properly the task of the court on all the evidence at the end of the day, and built that into their opinion of value. Yet it would be more helpful, and likely to take less hearing time exploring many and various issues with them, were they to have **expressed their opinion as to value in the alternative, depending on the Court's ultimate view of the disputed facts**. This then would give the Court a range from each of them and enhance the consideration of value overall.

(82) This is largely what I apprehend Warnick J to have been saying in *Ramsay and Ramsay* (1997) FLC 92-742, … If I am correct about that, then I agree with the greatest respect with his Honour's views.

(83) At any rate, I think that has some bearing on this concept of *value to the holder*. I say that because it is often surrounded by disputed facts. …….My point is that the Court's task of finding a value would be better assisted by leaving the fact finding involved to it and the valuers providing alternative views on each basis. " [bolding added]

75. Her Honour then turned to consider[63] "*the further question of how the Court goes about the task of bringing to account such benefits as may be found to exist by reason of their attachment to the holder's ownership of the shares*". Her Honour suggested that the valuers adopt a two step approach[64]:

"…if they were each to first express their opinion by a consideration of there being no additional or other benefits to the holder – thus allowing an assessment of their value to the individual holder having regard to broad 'market' considerations, based on sound valuation principles, without taking account of their individual family context – and then to offer their opinion of value by factoring into the exercise any identified benefits – to take account of what is not reflected in the initial assessment."

Value to the owner in thus seen as comprising two elements – market value plus the incremental value emanating from special benefits.

76. Her Honour had cautioned against abandonment of usual valuation principles/methodology [see para 72 above] and it is posited that these are quite adequate to the taskpecific comment going to methodology is at p28 of the judgment:

"It may be that in some cases a consideration of the additional economic benefits attaching to the ownership of the shares, by reason of the context of the particular holder, produces a different result in value. A simple example might be, say, a variation in the capitalisation rate to account for them where future maintainable earnings or dividends is the appropriate method."

The capitalisation rate has two components – the expected rate of return (based on the relative risk of the investment) and prospective growth. It seems unlikely that her Honour thought that the growth rate should be varied to account for additional economic benefits. But it is also hard to see how "economic benefits" per se impact the risk of the investment if "economic benefits" means incremental cash flows. The required rate of return depends upon how risky are the cash flows, not upon the quantum of the cash flows. The "special benefits" would normally reflect themselves as incremental cash flows [but not higher maintainable earnings of an underlying business]. These things being said, the "benefit" might in fact take the form of a reduced risk – see paragraph 23 above.

63 Para 84
64 Para 84

77. Moore J stressed [at paras 85, 86; "*it is not every case that economic benefits derived from the particular circumstances of the party/shareholder will go the exercise of valuing that parcel of shares*". It is necessary to distinguish between benefits which arise from the holding of shares and those which represent reasonable remuneration for employment, or those which are effectively gifts emanating from family circumstances.

78. In the event, the Court found [para 100] that "*there has not been demonstrated any special benefit to the wife by reason of her shareholding"* in [E] and [K] so that Mr K's primary methodology fell away.

AJW and JMW[65] (1998)

79. In this case Warnick J was called upon to consider the different approaches taken by the expert valuers in determining "value" of non-controlling parcels of shares.

80. The husband and one brother were the only directors of all five companies, except C where the husband's mother was "permanent governing director". All of the companies are described as "investment companies". The husband's valuer, Mr F, adopted a "value to the owner" standard, while the wife's valuer, Mr C, proposed a "fair market value" standard. Mr F applied a discounted cash flow calculation which "proceeded from the fundamental assumptions that upon the death of the husband's mother in the statistically anticipated 18.8 years time, the husband would be able to realise his shareholding or the underlying asset value of the share holding"[66]. The annual discount rate adopted was 5% yielding a present value equal to 40% of the net asset backing at the valuation date[67]. The wife's accountant applied a flat discount to the rateable value of the shares. The discount was 60% in the case of C and 55% in the case of B I and J K H. Accordingly, the "bottom line" of the two experts calculations would have been much the same but for the different assessments of the net worth of the companies themselves[68]. Warnick J described the issue between the accountants as a "*debate … beset by a degree of confusion, largely due to the terminology used, and a failure to adapt definitions appropriately into the field of property division in family law*"[69].

The expert's definitions of "value"

81. Under the heading "Approach to Valuation: Valuation Methodology – Value to Owner", Mr F's report contain the following passage:

"This value known as the 'value to the owner' considers and takes into account the additional economic benefits that ownership of the shares confers to the owners which, at the same time, would not enhance the market value of the shares to the purchaser. These benefits arise from special attributes or advantages which are peculiar to the owner and which may not necessarily be available to a potential third party purchaser."

His Honour observed that, contrary to the heading used by Mr F, "this is not a statement of a "methodology" but rather, of an "objective"". His Honour described Mr C's valuation approach in the following terms[70]:

"[Mr C] defined a "fair market value" as that at which a willing seller and a willing buyer, both informed of the relevant facts about the various entities, could reasonably conduct a transaction with neither person acting under compulsion to do so or anxious to buy or sell. Elsewhere in his report, however, [Mr C] referred to the fact that there was really no market for these shares. [Mr C] endeavoured to explain this

65 *AJW and JMW* [1998] FamCA 2377 (11 March 1998), Warnick J
66 At page 7.
67 Pages 9-10. Mr F's calculations are not shown, but the result of applying a 5% discount rate for 18.8 years is to reduce notional future value to 40% thereof: $[1 + 0.5]^{-18.8}$ = 33.96%.
68 The actual worth of the companies themselves is not discussed in the extracts from the case report published.
69 At paragraph 10].
70 At paragraph 27.

apparent contradiction by saying that the absence of market was not of particular significance, because the concept of "fair market valuation" usually dealt with the hypothetical vendor and hypothetical purchaser, rather than an actual purchaser."

While that observation is correct, **it is one thing to have a hypothetical vendor (although the "hypothesis" is really only that the known owner may sell, not as to the identity of the owner) and a hypothetical purchaser, where there is <u>in fact a market</u> (for it is assumed that an actual purchaser can be found); but it is quite another thing to speak of a hypothetical purchaser <u>where there is no market</u>.**

In fact, I question the relevance (and admissibility) of such evidence, when a hypothesis cannot be connected to the reality in the case." [bolding added]

His Honour refers to the overall approaches of the experts as "*objectives*". United Standards practice, in particular, uses the term "*standards of value*". No matter the terminology, the important thing, as Warnick J recognised, is that one must distinguish the objectives/standard from the valuation methodology to be applied[71].

82. As to Mr F's valuation, his Honour concluded:

a. there was no "*cogent connection between the choice of methodology [ie DCF] and the existence of any "extra" benefits to the husband, and more particularly the valuation of those benefits*"[72];

b. Mr F had conceded in cross-examination that "*there were no economic benefits received by the husband as a result of his shareholding which do not derive from the shareholding per se and could not therefore, be passed to at least a hypothetical purchaser*"[73;]

c. it followed that the basis upon which Mr F had said he had selected his methodology was absent. But, because the use of the DCF methodology did not, in fact, depend upon the value to the owner approach, "the ultimate result might still be valid"[74];

d. but "the fundamental difficulty" with Mr F's approach was "*the assumption that the husband would be in a position to realise his shareholding upon the death of his mother. This assumption in turn involves a series of assumptions as to the way in which the other shareholders will act at that time. These assumptions are the very sort of speculation to which I made reference in Ramsay v. Ramsay as not being an appropriate field for opinion evidence by accountants*."

83. His Honour found that "*on present shareholdings and corporate structure*[75]*, after the death of the husband's mother, the husband will remain a minority shareholder, and his shares will still lack marketability*"[76]. His Honour thus preferred the methodology of Mr C. There is no discussion in the judgment as to how the 60% discount proposed by Mr C is arrived at. And it is not clear what discount his Honour applied, although it appears that both accountants ultimately proposed the same (flat rate) discount. Mr C's "fair market value" standard had been rejected by his Honour but it appears that his Honour was saying that that did not matter because Mr C was in fact proposing a value to the owner standard.

71 At paragraphs 12-14.
72 Paragraph 39.
73 This is somewhat confusing – it is not stated why a real third party purchaser would enjoy the benefits described by Mr F in his report, viz loans advanced to family members and use of real property owned by the group.
74 Paragraph 42.
75 There was no other evidence available as to the intentions of the relevant parties.
76 Paragraph 48.

84. His Honour concludes:

"In the end, the significant difference between the accountants lies not in the difference in "objectives" nor in "methodology", but in the assessment of values of the assets of the companies in the C group."

While this was the practical outcome, the valuation methodologies proposed by the accountants were quite different. The fact that each accountant proposed a value which mathematically represented a flat discount of 60% of rateable value appears to have been entirely fortuitous. If, for example, the mother's life expectancy had been 10 years, Mr F's proposed flat discount rate would have been 39%[77]; if the discount rate proposed had been, say, 7% the proposed flat discount rate would have been 72%[78]. Based on the limited data available in the judgment it is not clear how, or if, Mr C's flat discount would have been changed.

85. As to his Honour's views as to the standard of value to be applied the following extract is significant [at paragraph 14]::

"There can be no doubt that the objective of the valuation is to assess the value of the share to the husband (owner). (see *Harrison and Harrison* (1996) FLC 92-682, at p 83,087). That is so **whether there are "special benefits" or not,** though if there are special benefits, they must be valued in achieving the objective. However, the **use of the term "value to the owner" in Family Law property cases, should not be dependent on the existence of special benefits, but rather as descriptive of the objective of the valuation exercise.**"

PART E: VTO CASES DEALING WITH PROPERTY NOT BEING NON-CONTROLLING INTERESTS IN COMPANIES

86. The application of the VTO standard is not restricted to case dealing with minority or non-controlling interest in companies. Courts have applied a VTO standard in dealing with the valuation of, a controlling interest in an accounting practice (*Hegarty – see paragraph 99 below*), a non controlling interest in a medical practice partnership (*Scott – see paragraph 108 below*), and a 50% interest in a company providing film production services (*Wall* – see paragraph 137 below). Although it is not explicitly stated, in effect a VTO standard was applied in respect of a non-controlling interest in a large legal practice in *Best*.

Best (1992)[79]

87. In *Best* the husband was partner in a very large firm of solicitors. The husband's expert argued that the value of the husband's interest in the partnership comprised only the balance of capital accounts and current accounts. The wife's expert added a further amount described as the "capitalised value of future earnings" calculated as shown in the following table, which also shows the Court's calculation, described below:

---

77 $1 - [1 + 0.5]^{-10}$
78 $1 - [1 +0.7]^{-18.8}$.
79 *Best and Best* (unreported). No PA 2832 of 1991

	Husband	**Court**
Maintainable profit	376,422	376,422
Notional salary	(140,000)	(225,000)
Notional interest	(31,518)	(31,518)
Total	204,904	119,904
Tax at 51.48% (recognising non-deductibles)	(105,485)	(61,726)
Future maintainable super profit, after tax	99,419	58,178
Capitalisation rate	36%	36%
Capitalised value of future earnings	$276,164	$161,605

88. The Court noted that the husband's partnership interest was not transferable and was not realisable by sale, or on death or retirement. The partnership agreement precluded the receipt of any payment in respect of the interest in the firm upon ceasing to be a partner and there was no entitlement to any payment in respect of goodwill. Gee J opined that entering into an *Everett* assignment[80] would be of no advantage and could not be done, and concluded:

"When all is said and done, such interest is in my opinion a financial resource, albeit a defined one, and not 'property'. The husband's interest in the partnership is……not a valuable asset or a marketable commodity in the sense of 'property' under the Act, but basically an expectation, albeit very real and very imminent, of future income or gain."

89. His Honour accordingly treated the husband's partnership interest as a financial resource under sec 75(2). However, in case it be found that the interest was in fact property, his Honour reviewed the calculation of the wife's expert shown in the above table. In the light of the evidence given the court determined that the fair salary should be adjusted to give an amended "*figure of capitalised value of future earnings*" of $161,605. It may be observed that there appears to have been no evidence on salaries given in the case beyond that of the expert valuers, a matter commented upon when the case was considered by Moss J in *B and B* (see below) where the salary factor assumed considerable importance:

"….it would appear from a reading of the judgement at first instance (Gee J, unreported, 22nd December 1992) that neither of the witnesses who purported to give evidence as to the so-called reasonable salary of the solicitor in question were qualified to give such evidence, in that each lacked the relevant expertise (see pp110-112))."

90. On appeal[81] the Full Court reviewed, inter alia, the decisions in *Everett*, *Galland*[82] and *Reynolds* and canvassed extensively the concept of "property" in the context of the Family Law Act. The following passage from the judgment[83] is particularly relevant:

"In the ultimate, the submission by counsel for the husband was that it was notional and illusory to treat the husband's interest as property and then to ascribe a value to it and that this process lacked "a sense of reality". He submitted that the interest was not really transferable, it was not saleable and it was not capable of being mortgaged or used as security. These appear substantially to be the reasons which led the trial Judge to conclude that it should not be treated as property but as significant financial resource.

80 See *FC of T v Everett 80 ATC 4076*
81 *Best and Best* (1993) FLC ¶92-418
82 *FC of T v Galland* 86 ATC 4885
83 At p 80,291

However, as counsel for the wife pointed out, this is to confuse the nature of the interest with the methods and difficulties of valuation.

We have already referred to the difficulties and artificialities which can arise around this issue of what is and what is not property within s.79. It is **beyond controversy that in ordinary circumstances the interest of a partner is property**. In this particular case the documents constituting the partnership agreement define the rights of the partners in particular ways and remove or limit a number of the characteristics which one would normally associate with a partnership share. However, the fact remains that the husband, as a partner has a number of rights in [the partnership] and this rights, although truncated, constitute property. That conclusion remains valid, notwithstanding there may be difficulties in valuing that interest and that in the ultimate there may be practical difficulties in making that interest the subject of, at least directly, orders under s.79. **The former of those issues is not a difficulty in this appeal since the valuation which his Honour accepted has not been challenged**. The latter remains a difficulty in this case as it does in many others, but it does not lead to a conclusion that an interest which otherwise is property should not be treated as property." (bolding added)

91. It is evident then that the Full Court was not required to consider whether or not the valuation methodology applied by the trial judge was appropriate. On the other hand, if the interest was "property" then a valuation was required. It was conceivable, of course that, *because of its nature*, the interest, although property, might have no value. The trial judge thought that not to be the case. The Full Court did not appear to suggest that possibility, although again it did not address the valuation question. Of course, the difficult question had not been directly addressed: what does "value" mean? At first instance Gee J said[84] "*the husband's right to continuing and, indeed, to future income, in the partnership………cannot in my opinion be the subject of bargain and sale*." It thus had no market value. What his Honour valued was described by him as the "*capitalised value of future earnings*" and it was treated as a financial resource. However, counsel for the wife referred to the valuation by the expert Mr B as "*the value to Best of his interest*" as a partner, as had Mr B himself.

B and B

92. The same valuation issues arose in a similar fact situation in *B and B*[85]. In that case again the husband was a partner in one of the very large legal practices and a central issue was the worth of that interest. Importantly, the threshold question of the meaning of value had been addressed by the two experts who agreed that, if the appropriate basis of valuing the interest was to determine what it could actually be sold for by a willing seller to a willing buyer, then there was no value beyond the net present value of the husband's capital account and other balances with the partnership. The expert retained by the wife, following the approach in *Best,* put forward a valuation in excess of the capital account value using a discounted cash flow approach applied to "super profits". This additional value was characterised as the "capitalised value of future earnings", again following *Best*. The expert retained for the husband contended that any value above the value of the capital balances constituted notional goodwill and reflected no more than a financial resource of the husband.

93. If the approach adopted by the wife's expert were accepted, there were three matters in contention:

i. the ascertainment of an appropriate salary to be deducted in calculating "super profits": The experts had acknowledged that they were not remuneration experts. The managing partner of the partnership gave evidence to the effect that the husband could command a market salary in excess of the maintainable profit figure attributable to partner in the position of the husband agreed by the experts ($750,000). The husband also provided evidence of offers made to him. The evidence was accepted, no evidence being adduced to the contrary, and that was sufficient to determine that the interest was of no value (above the capital accounts);

84 At p110
85 B and B (2000) FLC ¶93-002 (Moss J)

ii. the appropriate period of projected cash flows to be discounted: the experts had agreed that the appropriate period was until the retirement of the husband; evidence of the husband as to his intended retirement date was accepted;

iii. the appropriate discount rate to be applied assuming the DCF approach to be applicable: the expert for the wife contended for a discount rate of 20% (real) . The husband's expert applied a significantly higher rate which reflected a minority discount of 25% and a discount for lack of marketability of 50%. The Court did not canvass the issue of minority discount, rejected the wife's expert's contention that no marketability discount was appropriate and accepted the discount rate proffered by the husband's expert. The marketability issue is not dealt with in any depth but appears to have been rejected on the basis that it was not sensible to postulate that something which was not marketable could have a higher value than an identical asset which was marketable.[86]

94. Moss J set out several passages from the report of the husband's expert which his Honour considered to "illuminate the valuation issues" in the case. Those passages drew the distinction between value in exchange and value to the owner. The passages include the following[87]:

"We are aware that the Family Court of Australia has recognised, on occasions, in the context of property settlement that it is appropriate to recognise, in certain cases, a higher value than an equity may have to a party as compared to the value that might be determined if it were held by others in the usual commercial context. The application of such an approach is, in our opinion, both cogent and appropriate in some circumstances. The underlying principle is to recognise that in the hands of a particular party an item has a greater value than it may have in the hands of the broader community.

A classic example of a situation where such an approach may apply is where party A holds a minority interest in a company where the remaining shares are closely held by members of his or her immediate family. The commercial interests of the immediate family in the company are consistent with those of A, who can be confidently expected to act in concert with A's interests.

Whilst the minority interest of A would still be expected to attract a discount, the rate of discount would be substantially less than that which would objectively be applied if A's shares were held by a third party who had no relationship with and no common interest with other shareholders.

The consequence of the lesser discount rate is that the special value of the shares in A's hands as a value to him or her, as opposed to others, is recognised.

It is inappropriate for such a concept to be used to provide support to the valuation of the property interest in the present case by a super profits methodology. This is because the interest is not assignable (for value) in the hands of the Husband or any other partner or any other person. In other words, the interest has no greater value in the Husband's hands than it does in the hands of anyone else."

95. The logical connection between the last two sentences requires some scrutiny. In any event, His Honour did not discuss the detail in this passage but concluded that, if the husband's interest in the partnership was property at all, "*the appropriate basis on which to value the [husband's] interest in the partnership is to attribute no value to it beyond the value of the capital interests*." His Honour then turned to consider the question of whether or not the partnership interest was "property". His Honour distinguished *Best* on the basis that, in that case, the partnership interest was assignable, albeit that the partnership agreement required certain approvals and a permitted assignment was otherwise subject to restrictions. In the present case the unchallenged evidence was that the partnership interest was

86 The critical point is that the asset is marketable at a price (down to zero) which is less than the value to the owner. There is no difficulty in logic because the "marketable" asset is not "the same as" the asset which is held.

87 At p 87,088

inalienable[88] – the partners could not sell or otherwise trade their interest in the partnership.

96. Moss J reviewed a range of authorities dealing with particularly with the proposition that an interest must be capable of alienation or assumption by a third party in order that it be capable of being characterised as property. Based on that review his Honour concluded that:

a. In *Everett* and *Galland* the relevant partnership interests were assignable so that, in concluding that the relevant interest in *Best* was property, the Full Court of the Family Court was simply applying the earlier High Court decisions. No case referred to by before the Full Court decided that a partnership interest which was unassignable was property[89];

b. assignability is not in all circumstances the crucial test as to whether an interest constituted property. However, said his Honour, unassignable interests are held to be property only where the condition of unassignability has been imposed by statute, or by the document creating and evidencing the property or by taking into account reasons of public policy: "*The distinction turns, therefore, on whether the particular interest is inalienable by reason of its nature, in which case it will be excluded form the category of property.*" [90]

c. His Honour acknowledged again the distinction between "value in exchange" and value to the holder after citing the following passage from the decision of the High Court in *Kelly*[91]:

"The learned trial Judge found that both the Applicant and the Respondent believed that under the law as it then stood the permit was personal to the Respondent, could not be transferred to anybody else, would lapse if the Respondent died 'and was therefore a valueless asset'. That is not, of course to deny that the permit was of **considerable value to the Respondent personally** for so long as he desired to continue to dive for abalone and remained medically fit." [bolding added]

d. the partnership interest in the present case "*is to be classified as a non-assignable chose in action and therefore as a personal right in the [husband] rather than a right of a proprietary nature*." [92;]

e. that did not mean that the interest had no value but it did mean that it had no value in exchange. Thus, no order could be made pursuant to sec 79 of the Family Law Act in respect of the interest because it was not property[93]. However, in the present case, that made no difference because his Honour had taken account of the full value of the interest being only the capital accounts.

97. The wife appealed but not on any issues relating to valuation. In the course of reviewing the findings at first instance as to the partnership interest the Full Court commented[94]:

"[Moss J] valued the husband's partnership interest in C at the sum of $110,827. That finding was not challenged before us. Later in his reasons, his Honour said:-

---

88 At p87,084, paragraph 44

89 At p87,089, paragraph 77, p

90 At p87,089, paragraph 80. His Honour referred inter alia to the decisions in *Georgiadis v Australian and Overseas Telecommunications Corporation* (1994) 179 CLR 297, at 311 and generally to *Ex Parte Meneling Station Pty Ltd* (1982) 158 CLR 327. Support for the proposition that "*it is generally correct to say that a proprietary right must be capable in its nature of assumption by thirds parties*" was given, said his Honour (para 89) in *Hepples v Commissioner of Taxation* (1990) 22 FCR 1 , at 25-26, and by the decisions in *Dorman v Rodgers* (1982) 148 CLR 365, and *Kelly v Kelly* 64 ALJR 234

91 At p 87,092, para 101. The passage is at p235 of *Kelly*.

92 At paragraph 105

93 Citing the decision of the High Court in *Mullane v Mullane* (1983) 158 CLR 436

94 *B and B (No 2)* (2000) FLC ¶93-031, at p 87,498

105. The fact that in my opinion the partnership interest is to be classified as a non-assignable chose-in action and therefore as personal right in the Respondent rather than a right of a proprietary nature, does not mean it has no value (although it does mean it has no value in exchange)."

…

106. However , it follows that no order pursuant to s 79 of the *Family Law Act* can be made in respect of the relevant interest because the interest does not constitute property: *Mullane* (supra). In some cases, as where the interest was the only item of value, or where the relevant property was of a modest value, such a finding could result in an outcome significantly different to that which would have been the case had an item been classified as property.

107 However, in the circumstances of this case, given the value of the property and the nature and extent of the contribution and the other relevant factors that have to be taken into account, the classification of the partnership interest as comprising a right personal to the Respondent will have no practical significance. The Respondent's interest will be taken into account at the value I have found it to have and orders will framed on that basis, with the result that the value of the Applicant's entitlement pursuant to s. 79 of the Act will be no different than would have been the position had the interest been classified as property."

Senior counsel for the wife observed that, although these conclusions were, in his view, open to question, they were not the subject of challenge in the appeal. Accordingly, no submissions were made to us in relation to them. It would thus not be appropriate for us to express a concluded view. in relation to his honour's findings. However, **we should not be taken as endorsing his conclusions**." [bolding added]

98. The position with regard to valuation of interests in substantial professional practices thus appears to remain somewhat uncertain. From a valuation perspective the following may be noted:

a. if the reasonable salary had been less than the maintainable profit figure (before salary) then Moss J would have found that the partnership interest had a value in excess of the capital accounts[95];

b. in Moss J's view the interest was not property and had no value in exchange; but it could have a value to the owner – this appears to be finding opposed to the views put by the expert for the husband that there was no room for the operation of this concept in relation to an inalienable interest in a professional partnership of this kind [see paragraph 94 above];

c. because it was not property, Moss J found the interest could not be the subject of an order under sec 79. It appears that the reservations of the Full Court relate to this issue. If the interest is property and if value to the owner is an appropriate basis of valuation, then it seems that there will be many instances, even though there will be restrictions on alienability, where the fair salary of a partner is less than maintainable earnings before salary so that there may be significant value found.

95 Although the DCF approach treats the capital accounts as recoverable at termination of the cash flow period, so that that proposition may not be correct where the present value of the cash flows is less than the face value of the capital account.

Hegarty

99. In *Hegarty*[96] the husband held a 50% interest in an accountancy practice, Rolins. Although the capital interests were equal the distribution of profits was shared in accordance with a formula based on revenue which effectively gave the husband a higher share. The husband's practice was highly specialised and depended heavily on one type of client. The wife's expert conceded in cross examination[97] that "*if the husband decided not to stay in Rolins, but to sell his interest, then…….the interest would, in those circumstances, have a very low or almost no value.*"

100. The two accountants valued the interest as follows. In each case there appears to be no consideration of issues relating to lack of control. The starting point is the share of income accruing to the husband.

	Mr W	**Mr W**	**Mr B**	**Mr B**	**Court**
	[Husband]	[Husband]	[Wife]	[Wife]	
	High	Low		*Note 1*	
Super profits	129,000	103,000	190,000	177,000	177,000
Discount rate			12.9%	12.9%	
Period till retirement (yrs)			9	9	
Present value (Note 2)			978,650	911,690	
Net tangible assets			50,702	50,702	
Value of interest			1,029,352	962,392	
Rounded			1,030,000		
Capitalisation rate	30%	30%			30%
	430,000	343,333			590,000
Net tangible assets					50,702
					640,702
Implied "capitalisation rate"			*19.41%*	*19.41%*	
Note 1: it appears that Mr B's super profit was amended by him to $177,000					

Note 2: Although it is not shown in the judgment the calculation must have been effected as follows: Present value of an annuity			
Present value of $1	Formula	(((1-(1+i)^-n))/i	
	P.V. factor	5.151	5.151
Total value of super profits		978,650	911,690

101. Although Mr B referred to his rate as a discount rate (and so applied it) every reference by the judge to Mr B's rate is to a "capitalisation rate". Certainly that may not have affected the outcome because Baker J was of the view that Mr B had not properly taken account of the relevant risks. But consider, for example, the outcome if the remaining term were shorter. At 5.64 years Mr B's "implied capitalisation rate" would have been 30% also, but the higher implied rate is driven by the shorter term not by an altered assessment of risk. It is submitted that it is always preferable to consider the remaining likely term of the income stream.

102. In any event the court did not apply a market value standard. Reviewing the earlier decisions, Coleman J concluded that "*commercial concepts of valuation*" were not, to use the now familiar term, "realistic" [at paragraph 50]:

"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

96 *Hegarty & Hegarty* [2002] FamCA 883
97 At paragraph 43

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."

103. Having dealt with the question of the objective [but without defining what "*worth something to the husband*" means in conceptual terms], his Honour turned to methodology, although there is no definite delineation between the discussion of the standard to be applied and the methodology to arrive at value.

"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."

104. The immediately following passage is difficult to construe:

"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."

105. The first sentence seems to suggest that his Honour is saying that a different capitalisation rate might be applied to assess VTO[98] [as opposed to market value] or, possibly, that the capitalisation exercise, including assessment of the income to be capitalised, is looked at differently when assessing VTO. Alternatively, the words may simply be a general introduction to the discussion of the capitalisation rate and earnings which follows in the judgment. The last sentence is, with respect, confusing. What the husband gets when he sells is market value, not the ""*value" determined*" which, it appears in the context of these words, is "real value"/ value to the owner.

106. It is not entirely clear from the judgement whether the experts set out to calculate market value or VTO and what they saw as the differences. It appears [para 30] that Mr B saw the distinction between the two as only attributable to the fact that "*the husband has an interest in ongoing profits which is at variance with his interest in the capital value of Rolins and for that reason the present value of the Husband's super profits exceeds the value determined on a capitalisation of future maintainable earnings.*". In cross examination Mr B conceded that the sale value of the husband's interest was very low or almost nothing [para 43]. The husband said Mr B applied VTO incorrectly [para 43]; the Wife said Mr W should have applied VTO and did not [para 42].

107. In any event, it is submitted that the Court was most cognisant of "market" factors when assessing both prospective earnings and the capitalisation rate. The value adopted is the present value of the income stream to the husband on the assumption that he will not sell the interest. It is acknowledged that a sale would realise a lower amount essentially because of the risk of loss of clients, which risk was (largely) averted on the likely scenario that the practice would not be sold. His Honour nowhere alludes to the possibility that the husband may in fact later wish to sell the practice. Neither is there any explicit

98 Cf the discussion at paragraph 76 above

quantification of market value even though the practice had in fact been purchased some years earlier[99.]

Scott

108. In *Scott*[100] the husband was a medical practitioner. The case dealt with the valuation of an interest in a medical practice conducted through a partnership/trust structure. Both experts stated their objective as being to ascertain “value to the owner”.

109. For purposes of admitting new partners and paying outgoing partners the goodwill figure of $84,400 provided for in the partnership agreement had consistently been used. Mr J, the expert acting for the husband, arriving at an overall value for the interests held by the Husband of $96,895 which included the goodwill figure at $84,400. Mr M, the expert acting for the wife, applied a capitalisation of earnings approach arrived at an overall figure of $247,708, but revised that figure to $196,000 in the joint statement consequent on a reduction in the fair salary figure from $190,000 to $145,000 [Mr J suggested a salary figure of $114,000 was appropriate].[101]

110. The trial judge adopted the revised figure of Mr M. On appeal the Full Court considered the fair salary, the capitalisation rate and [para 60]:

“whether in the face of the partnership agreement that stated a goodwill figure, and a history of partners entering and leaving the partnership in accordance with that agreement, capitalisation of future maintainable earning was an appropriate [*sic. this should apparently read “inappropriate*”] methodology and should have been rejected by her Honour.”

This last point clearly necessitated a consideration of value to the owner.

111. Importantly, on appeal it was made clear [as had not been clear earlier] that:

a. Mr J’s conclusion depended on selecting the higher of the “asset backing” value represented by the partnership goodwill figure of $84,400 and the result of applying a capitalisation of maintainable earnings approach. In this case the latter produced a lower result based on Mt J’s fair salary figure;

b. the CME result represented value to the owner; the net asset value also represented value to the owner, although impliedly it also represented market value.

112. The following passage [para 63] is instructive:

“In argument before us the husband's position was synthesised and the husband's counsel put his argument, not on the basis that the trial Judge should have found that Mr [J] had valued the interest in the practice on the basis of recent sales, which she rejected, but rather that (transcript 30 November 2004, page 9):

[W]e say Mr [J] approached the matter in the way that a methodology of valuation should be approached - namely, giving consideration to **value to the owner** and then giving consideration to whether, in effect,

---

99 Fees purchased were $1.6 million at a price representing 46 cents in the dollar [para 28]. I assume this was goodwill only. It is not clear to what extent the fee base had changed but the forecast fees were $2.5 million. Assuming the husband derived say 55% of the net income [see paragraph 29] his Honour’s findings on goodwill value translates to $590,000 / 55% = $1.07 M / $2.5M fees = 43 cents in the dollar. Again the dependence on specialised work may have increased and so saleability declined, but it may have been of some assistance to obtain a market value assessment. Cf Warnike J in *Ramsay*. It is not explained why the Wife’s expert had conceded that the market value was “very low or almost nothing”.

100 *Scott & Scott* [2006] Fam CA 1379 (21 December 2006).

101 The full details of the various calculations are not disclosed in the appeal judgement and the first instance judgement is not reported.

the commercial aspects of the venture and the asset backing, in fact, produces an outcome which is either similar to or higher than that which the capitalisation rate produced. [our emphasis]"

113. Accordingly, it was conceded on behalf of the husband that, if the CME approach produced a higher result, that would be the "value" [to the owner] to be adopted, regardless of the "commercial aspects". Thus, concluded the Full Court, :

67 'The gravemen of this concession is that the apparent divergence in methodology presented to her Honour at trial was more illusory than real and that both valuers used the capitalisation of maintainable earnings methodology, albeit in slightly different ways, to arrive at a value.

68 True it is that counsel for the husband contended that "cross-checking" against the partnership agreement was prudent but it is clear that his contention that the amounts paid to outgoing and incoming doctors was "commercial" and represented value to the owner, relied upon the premise that a capitalisation of maintainable earnings using Mr [J's] variables, produced a result equal to or less than that paid according to the partnership agreement."

114. The Full Court found that her Honour "*was not bound to accept the valuation methodology based on the goodwill as expressed in the partnership agreement, as opposed to the capitalisation of maintainable earnings and her failure to do so did [not] constitute an error of law*" [para 73]. The following passages explains the reasoning of the Court to this conclusion:

74. "At paragraph *42* of the reasons for judgment her Honour considered the concept of "value to owner", having considered various relevant authorities, namely *Reynolds and Reynolds (1985)* FLC *91-632, Turnbull and Turnbull (1991)* FLC *92-258,* and *Harrison and Harrison (1996)* FLC *92-682.* In our opinion, the trial Judge correctly interpreted the law as it stands in relation to the value to be placed upon interests in family companies.

75. Her Honour found that there were similarities between the valuation of shares referred to in those cases and the valuation of the husband's interest in the medical practice and the Trust. Whilst most of those cases do not relate to the valuation of shareholding in a corporate structure emanating from a professional practice, the same methodology has been applied to professional practices: *Best and Best (1993)* FLC 92-418.

76. Whilst it might be prudent to be cautious when considering a professional practice which underlies a corporate structure, when the ultimate issue is value to the owner, we observe that in this case, her Honour had two expert witnesses offering different opinions and a discretion to be exercised on reasonable grounds, to accept or reject their evidence.

77. Given the approach adopted by the husband's counsel, namely that if the husband's valuer's figure for salary was used, capitalisation of maintainable profits was not an inappropriate methodology, it was in our view open to her Honour to accept the methodology applied by Mr [M] and the consequent valuation, and we find no merit in this ground."

115. The CME methodology is commonly applied in similar contexts and there is nothing in the judgement to suggest that either valuer made any modifications to the methodology in recognition of the fact that the VTO standard, rather than market value standard, was being applied. What might seem a little puzzling is the inconsistency between the values arrived at by the CME methodology [both of which would have exceeded the partnership agreement figure if the fair salary adopted by the Court was used] and the actual behaviour of the market participants, being the doctors buying and selling an interest in the practice. In the minority interest cases, and those other cases where there exist benefits associated with a shareholding which could not be availed of by the buyer, one can understand the logical basis for a distinction between market value and VTO. But what is the logical basis in *Scott*?

116. There is no consideration of this issue by the Full Court. In the initial judgment the trial judge had said [quoted at para 45]:

"In my view there are similarities between the valuation of shares referred to in these cases[102] and the valuation of the husband's interest in the medical partnership and medical trust. The Partnership Agreement fixes the value of the goodwill but also provides for that value to be altered by agreement. *Harrison* (supra) supports the view that the husband's interests in the partnership and medical trust *"can only be valued on the basis of their worth to him"*. I therefore prefer the reasoning and method adopted by Mr [M], the chartered accountant rather than that of Mr [J], the chartered accountant instructed by the husband."

117. A possible hint as to the reason for the inconsistency described in paragraph 115 above is given in the following passage [para 46]:

"46. Mr [M] had previously referred to *Harrison* (supra) in the context of the joint statement produced by both experts (at paragraphs 4.22 to 4.23):

Mr [M] contends that the "value to owner" approach is relevant in this situation. Whilst there are regular admissions and retirements, there is no evidence in Dr Scott's tax returns of sales of partial interests. It could be argued that the amounts paid are, in fact, deposits which are refundable on departure. The stamped partnership agreement, dated 1st July 2003, appears to indicate a value of $0.00 (date stamped 11th September 2003).There is judicial support for the view that the *"value must be a realistic one, based upon the worth of the shares to the party himself or herself'* (Harrison and Harrison (1996) FLC at p. 83,807). Whilst the opinion relates to shares in private companies, the sentiment could well apply to professional partnerships where the admission/retirement procedures could be perceived to be manipulated to lower admission/retirement amounts for revenue or family law purposes."

118. No comment is made on his passage by the Full Court. I infer [and I apologise if I misconstrue what was said]] that it is being suggested that a retiring doctor would forego part of the value of his or her interest [by binding himself/ herself to sell at a lesser price] in order to avoid tax, or so as to be able to disclose a lower value in the context of a family law property proceedings. This would seem to be inconsistent with observed commercial dealings: around half of something is always better than 100% of nothing.

PART F: SOME RECENT CASES

Blake & Blake [2007] Fam CA 10 (19 January 2007)

119. Included in the trial Judge's calculation of the value of the parties' property was the former matrimonial home valued by his Honour at $1.65 million, a capital gains tax liability of $216,298 in relation to that property and a further CGT liability of $110,620 in relation to another property ("**the Sunshine Coast Property**"). On appeal to the Full Court of the Family Court, the Wife contended that the value of the home should have been $2 million on the basis of an offer made in 2004 and that the CGT liabilities should not have been brought to account as "present liabilities".

120. Having regard to various earlier decisions, Finn J concluded that "*notwithstanding that there was apparently no challenge to the genuineness of the offer of $2 million … I am not persuaded given the observations of the Full Court of the Federal Court in … Cordelia*" that the trial Judge was wrong in law [at paragraph 18]. As to the capital gains tax, Finn J reviewed the decision in *Rosati* and concluded that that case "*does no more than provide guidelines for the exercise of the property settlement jurisdiction under s79 of the Act, and must be applied as the justice and equity of the case in question requires*" [at paragraph 24]. Having regard to the Husband's desire to retain the property, its future development potential and the Husband's refusal of an offer of $2 million "*it could not … be reasonably asserted that it would be just and equitable for the Wife to have to share the burden of a potential future liability for CGT in relation to that property*" [at paragraph 25]. Finn J concluded that the Buckley J was entitled to make the deduction for CGT on the Sunshine Coast Property because neither party had opposed such a

102 The "cases" referred to by her Honour were *Reynolds*, *Turnbull*, *Harrison*, *Hull* and *Sapir*. Again, all of these dealt with minority interests in private companies.

deduction at trial and there was no basis for overturning that decision.

121. May and Coleman JJ noted that Counsel for the Wife had argued that "*the question is what is the value of the property to the Husband*" citing the decisions of Warnick J in *Ramsay* and *AJW & JMW*. Their Honours concluded:

"The facts in this case lead to a conclusion that his Honour could have accepted the evidence of the Husband's refusal of the $2,000,000 and in those circumstances placed the property at that value in the pool to be divided between the parties. **A concession properly made by Kirk SC was that if we adjusted the pool to allow the figure of $2,000,000 … then capital gains tax would also have to be deducted. In the alternative the trial Judge could have accepted the agreed value as provided by the experts, accepted the husband's evidence of a present intention not to sell and therefore not included an allowance for the capital gains tax**. In our view, the latter course is to be preferred in the circumstances of the husband's own evidence." [at paragraph 80] [bolding added]

122. As to the Sunshine Coast Property, their Honours concluded that the submissions of Counsel for the Wife appeared to have been misunderstood by the trial Judge [contrast Finn J]. However, on the basis of the Husband's evidence that he would have to sell the Sunshine Coast Property to discharge his liabilities including the settlement to the Wife, an allowance should be made for capital gains tax on this property.

123. The case presents an unusual set of facts but suggests that the value to the owner standard extends to all property.

Dalzeil & Weinstein [2008] Fam CA 777 (4 September 2008)

124. *Dalzeil* is a decision of Coleman J. One of the issues was the value of S Pty Limited, a company controlled and operated by the wife. Mr B, the joint expert, valued the whole of the interests in the company at $185,126 based on the application of a capitalisation of earnings approach. The husband asserted that the Mr B should have applied a "value to the owner basis", rather than market value, although it is not explained in the judgment [assuming the husband had explained it] how the husband would have seen that as affecting Mr B's conclusion.

125. The following extracts are relevant:

"113 Although the husband asserts that there was another basis, described by him as "value to the owner", pursuant to which Mr B could and should have valued S Pty Ltd, nothing to which the husband has referred this Court suggests that Mr B's methodology was other than acceptable and consistent with the principles which have long been recognised in this and other courts which entertain valuation disputes.

114 **To the extent that there is a distinction between market value and value to the owner, the Court would understand the distinction in practical terms to relate more to minority interests in an entity than to a case such as this. Where there is a minority interest which the evidence does not suggest is likely to be realised, or sought to be realised, there is arguably a degree of unreality in discounting simply because the interest is a minority interest. In those circumstances, the "value to the owner" is arguably the value of the interest as determined without discounting because of the difficulties associated with realising a minority interest in the market place**.

115 That scenario however does not arise in this case. Mr B, properly in the Court's view, was not considering minority interests, and valued the business as a whole, and determined its hypothetical valuation by reference to a reasonably willing but not anxious vendor and purchaser situation (see *Spencer v Commonwealth* (1907) *5* CLR 418, (1907) 14 ALR 253). He did not in any way discount the value of the business in reliance upon any restrictions or limitations in that hypothetical situation.

116 On the facts of this case, the Court does not perceive that Mr B failed to determine the value of

the business to the owner. As suggested to the husband during the trial, the valuation of S Pty Ltd was not the be all and end all of matters given that, in the context of s 75(2), the Court would have to consider the reality that, if she retains the business, as she will, the wife will have the benefit of an established and comparatively secure income stream with ancillary benefits.

117 Mr B proceeded in his report to apply a capitalisation rate to the future maintainable earnings which he determined by reference to the accounts of S Pty Ltd. Nothing raised by the husband provides a rational basis for concluding that any of Mr B's calculations, or the basis for them, was erroneous." [**emphasis added**]

126. It is of interest that the Court was of the view that "*the distinction [between market value and VTO] in practical terms … relate[s] more to minority interests in an entity than to a case such as this*." While the genesis of the VTO distinction is the minority interest cases, the application appears to have extended beyond that area – see eg *Blake*.

127. The remainder of the highlighted passage in the above extract ["Where there is a minority … minority interest in the market place"] suggests that no discounts at all should be applied in valuing minority interests where no sale is contemplated. This issue is considered further at Part I below.

Clarkson & Clarkson [2008] FamCA 1098 (12 December 2008)

128. This is a decision of Mr Justice Watt[103]. The facts are somewhat complex but, in essence, the starting point was a valuation by a Court appointed expert, Mr BN, of interests in various primary production ventures held by various companies in which the ultimate interests were held as to 50% by the Clarkson family. These valuations were not in dispute [para 120]. They took account of substantial discounts [overall around 40%] to pro rata values based on lack of control of particular projects, lack of marketability, the outlook for the industry, working capital requirements and other factors [para 126].

129. Having arrived at a value of the overall pool in which the Clarkson family held a 50% interest, two other experts then offered different opinions about the value of that 50% interest.

130. In his report, Mr S applied a discount to each underlying investment of 10% to 15%. In the various tables included in the judgment these discounts are described as "*realisation of cost allowance*" [paras 68-172]. Mr S amended his view in the course of the trial on the basis that there existed further "benefits" provided to the husband. As explained by his Honour [para 173]:

"During the oral evidence Mr S dispensed with the application of any discount. His rationale for this was the existence of the mortgage which facilitated the purchase of the N property and the apparent willingness of VIPT (and Mr SE) to service the interest for three years."

131. Mr CK applied a discount of 50% to Mr BN's valuations "*to reflect the illiquid nature of the investments*". Additionally, he alluded to other factors supporting a discount: the interests were not held directly but through a number of entities; a buyer would need to come to some arrangement with the other 50% shareholder; the most probable buyer was the other 50% shareholder, who may not be willing to purchase, and the alternative to sale was liquidation which would result in reduced sale prices and liquidation costs [para 191].

103 The case contains a discussion of the trial judge's duty to determine value rather than merely choosing between competing valuations [para 198 *et seq*].

132. His Honour reviewed, or alluded to, "the usual suspects" relating to value to the owner: *Reynolds*, *Hull*, *AJW*, *Turnbull*, *Ramsay* and *Harrison* [para 202-215]. The Wife relied on *Harrison*, on the basis that the Husband was deriving similar benefits [para 215]. The benefits included a salary of $90,000 provision of a motor vehicle, mobile telephone, and travel and accommodation costs to meet investors and to inspect properties at paras 210-211. His Honour commented:

"With respect to these benefits, Mr CK had to concede that if the Husband was to retain the Clarkson Family Group's interests their value would be greater to him than an independent third party purchaser. Despite this he did not consider that value of the Clarkson Family Group's interest to be equivalent to the assessment of their net tangible assets as prescribed by Mr S. Nor did he believe that the current value of shares would be the same as their potential realisation in the next three, four years, or beyond." [para 212]

133. There is nothing in the judgement to indicate that the benefits were perceived to be, or obviously were, excessive in comparison with an arms length salary. If the benefits are fair arms length payments then it is difficult to see how they should impact the share value. In any event, his Honour concluded that the benefits were unlikely to continue "*if, as predicted by Mr BN, there is a further oversupply of fruit, contracts to purchase fruit are not renewed when they expire, and, in his recent experience, contracted fruit buyers simply tell the supplier that the contract price will not be paid, and a lower price will be paid instead*" [para 216].

134. The wife's case was that [para 216]:

"Because the husband will retain his interest for "some time" and because there is "no immediate need to sell" the Clarkson Family Group the value to the owner is the appropriate objective of valuation. Counsel for the wife argued that this objective should be utilised when there is no "true market" for what is being sold."

135. In the event his Honour found that Mr S had "*attached too much weight to the apparent generosity of the loan documentation*" [at para 217] and adopted market value [para 219]:

"I find that Mr S's abandonment of his discounts (ranging from 10% to 15 %) was not well founded, for the reasons that I have identified. I have already recorded that Mr Crofts, in final addresses, offered me the comfort of being able to apply a 10% discount. I consider that Mr CK's discount of 50% was posited on a much shorter selling time frame than is likely to occur, in my view, and was based on all assets being offered together for sale at one time. Having regard to the very poor outlook for the industry which I consider had worsened by the time that Mr BN gave his oral evidence; I consider that a discount of 20% above the discounts already applied by Mr BN is appropriate. Accordingly the value of the Clarkson Family Group is $1,904,750, made up of the net tangible assets of the Clarkson Family Group of $2,380,938 less a 20% discount of $476,187."

136. The following observations may be made:

a. The Wife's expert had withdrawn from allowing a 10% to 15% discount "*because of the ongoing relationship as evidenced by the N property loan documents………… the apparent generosity of the loan documentation – three years with no interest payable by the husband*." In effect, he had made a "value to the owner" adjustment reflecting a benefit available. It was clearly possible, one would have thought, to calculate the value of this benefit and to demonstrate how this equated to the 10-15% discount but it does not appear that that was done. But, in any event, it is submitted that the appropriate place to make this adjustment was in valuing the indebtedness of the Husband to the relevant company and in valuing the lender company itself, not by way of offsetting a discount which the expert would otherwise have allowed against the value of all interests.

b. However, it seems that the Court would have been prepared to add an increment in respect of "benefits" being obtained by the Husband, which on their face were not obviously in excess of fair arms length payments, except for the perception that they were not sustainable. This is without any apparent consideration of whether or not the benefits were in excess of a fair arms length charge.

PART G: PERSONAL GOODWILL AND VALUE TO THE OWNER

137. An area where an "owner value" approach may be inappropriately applied relates to the determination of the value of a business which demonstrates significant personal goodwill of the wife/husband, rather than alienable commercial goodwill. There may be a temptation to proceed on the basis that the personal goodwill should be included in the value calculation because, in effect, the personal goodwill is of value to one or other or both of the parties. This view was rejected in *Wall*[104].

138. In that case the husband and his de facto wife were the only shareholders in a company through which they carried on the business of film producers and directors. At first instance the Court had valued the shares at $110,000, attributing $55,000 to each of the 50% shareholders. The value of the company included a value attributed to goodwill of $102,000 calculated at two years "superprofits".

139. The Full Court held that the trial judge had erred in treating the personal goodwill of the parties as commercial goodwill [at para 70]. Once that personal goodwill was excluded the shares had little value. The Full Court explained that the personal goodwill was an element of the husband's earning capacity which capacity represented a significant sec 75(2) factor.

140. However, the Court accepted that the fact that the business relied on the skills of the directors did not mean that the (commercial) goodwill was worthless:

"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 (eg, professional practices) are considered to have some goodwill. As Mr [B] said in his report…"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)."

141. The Full Court of the Family Court accepted the conclusion of the trial judge that the value of the share was to be determined "in the husband's hands"; that proposition was said to be supported by the decisions in *Turnbull*, *Sapir (No 2)* and *Harrison*. In assessing this value to the owner, the Full Court said [at para 74]:

"We think that it was open to his Honour to find that the husband's share had some value in his hands because it conferred on him some benefits which he could not have obtained as a sole trader (eg., 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."

---

104 *Wall and Wall* (Unreported No EA 83/99). Full Court of the Family Court, 26.10.00. See [2002] Fam CA 257

PART H: WHAT PRINCIPLES CAN BE EXTRACTED : VALUATION STANDARD

Definition of "value to the owner"

142. Can we arrive then at a working definition of value to the owner? I proffer the following suggestion:

"what a reasonable, prudent business person, in the position of the holder [husband or wife], willing but not anxious to exchange the asset for cash, and reasonably informed of the relevant facts, would see as the cash equivalent of the relevant asset to him / her."

The definition looks to an objective[105] standard without any reference to a "hypothetical" or notional buyer. The "relevant facts" will include an appreciation of market factors including those relevant to the assessment of risk.

Is value to the owner the standard in Family Law cases?

143. In an article[106] published in the September 2000 issue of the [United States] *Business Valuation Review* Alan Zipp proposed the adoption of the following standards for valuation in the context of divorce proceedings:

". If the business interest is publicly traded, or if the business interest is expected to be sold, then the appropriate standard of value is "fair market value" as defined under the tax law …[107]

. If the business interest is not expected to be sold, or if the business interest is not a marketable, then the appropriate standard of value is "divorce value" defined as the economic value of the business interest to the current owner."

144. In Australia, these principles appear to have emerged:

a. although it makes no difference where VTO equals market value, the standard to be applied in valuing business interests is always value to the owner – this is evident from many of the cases discussed in the paper although, in many instances, it is often not necessary to expressly consider VTO and it is merely taken for granted that market value and VTO are the same thing;

b. the VTO standard applies to all "commercial" assets, not just business interests (*Blake*);

c. "value to the owner" is the objective or purpose of the valuation exercise – it is a "standard of value" – It is not a valuation methodology[108] - see particularly *Ramsay, AJW and JMW* (supra);

d. in general, the mathematical/quantum difference between VTO and market value arises because of the existence of "special benefits". The fact that no special benefit exists does not mean that the VTO standard no longer applies; rather it generally will mean that VTO equals market value (*Ramsay*).

---

105 Of course, the subjective views of the valuer will or may come into play but that is the nature of all valuation practice.

106 Alan S Zipp, *Business Value Standards in Divorce*, Business Valuation Review, September 2000, p153

107 The fair market value standard is defined in the United States tax law as follows "The fair market value of any interest….in a business… is the net amount which a willing purchaser….would pay for the interest to a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of the relevant facts …". 26 CFR 20.2031-3. This definition is included in the Internal Revenue Service Revenue Ruling 59-60 as guidance to taxpayers in valuing the stock of closely held corporations for all tax purposes. This definition is very similar to the definition of "fair market value" in the International Glossary referred to at paragraph 10.

108 A valuation methodology is a mathematical way of arriving at a valuation. Examples of valuation methodologies include discounted cash flow or capitalisation of maintainable earnings.

PART I: WHAT METHODOLOGY SHOULD BE APPLIED TO ESTIMATE VTO?

145. Once we are comfortable with the objective – a standard of value, it is then necessary to determine a methodology for arriving at VTO. What is sought is to measure the present cash equivalent of the economic advantages which are expected to accrue *to the existing holder* from the holding, use and/or sale of the asset. It is submitted that the methodology applied must be based on sound commercial principles – adoption of a VTO standard "*is not an invitation to abandon principled methodology*" (*Barouche*).

146. Taking account of the other "basics" of a valuation it is appropriate to consider how, if at all, treatment of the following factors should vary if the valuer is applying a VTO standard rather than a market value standard in valuing a business:

a. the income/ cash flow to be capitalised or discounted;

b. the capitalisation rate/ discount rate;

c. discount for lack of marketability;

d. lack of control; and

e. tax.

147. Although again he is talking about United States practice it is useful to refer again to the paper by Alan Zipp described at paragraph 143 above. Mr Zipp argues that certain valuation adjustments which would normally be effected in determining fair market value are not relevant in the context of a valuation for divorce purposes:

"In divorce valuation, the key measurement of value is its economic worth to the marital community and its present owner. In contrast, the key measurement of value to a willing buyer is the future profitability of the business after considering all potential effects of the purchase, including synergies and economies of scale when combined with the buyer's existing business activities.

In making these considerations a willing buyer will often apply discounts for a variety of reasons such as the expected reduction in revenues due to the loss of the seller as a key person, as well as lost business contacts and relationships, and a necessary change in management. In addition, when the interest being purchased is less than controlling, the willing buyer generally reduces the pro rata value of the business for a minority interest discount. Also, since small businesses have no established market for their shares, willing buyers further reduce the value of a closely held business for its lack of marketability.

None of these considerations are relevant in the divorce appraisal where the owner will not be leaving the business as there will be no anticipated reduction in future profitability due to the loss of the owner or a change in management. Further, **discounts for minority interest and lack of marketability are relevant only to a willing buyer and have no consideration to an owner not contemplating the sale of the business interest.** The continuing owner is concerned with the economic value from the ownership interest, not a hypothetical sale to willing buyer." [**bolding added**].

75 It is implicit in Mr Zipp's formulation that the owner will never want to, or need to, sell, or at least not in a time frame which would affect a valuation based on a consideration of the present value of future cash flows. One must ask in each case whether that is a reasonable assumption, or indeed whether it is ever a reasonable assumption. This is relevant to all the matters referred to – profitability, minority and marketability. It must be asked also why lack of control issues are only relevant where the owner contemplates sale. Lack of control is relevant to the risk associated with deriving income / cash flow on a day to day basis. In this author's view that cannot be disregarded.

The income/ cash flow to be capitalised or discounted

148. The following guidelines are offered:

a. the income/cash flows to be dealt with should be divided into those which form part of market value and those which are items of "special value" with clear explanation for any assumptions made particularly as to special benefits [*Ramsay*, *Barouche*];

b. valuers should not "*take disputed or contentious facts and base their opinion on them as if they were beyond controversy" (Barouche*). It is acknowledged that, in practice, a valuer sometimes does not know what are the *"disputed or contentious facts*" until after he or she receives a report from the "opposing" valuer, which can sometimes rely on an entirely different "factual" framework. This may call for some refinement at the expert conference stage to assist the Court to identify what is contentious and what flows from each alternative;

c. only special benefits which "spring from" the shareholding should be encompassed in any valuation [*Georgeson, Barouche*]. This is an area, however, where there is some uncertainty (*Ramsay*) [see paragraph 64 above];

d. In the ordinary case the owner will not be contemplating the sale of the asset. If the asset is, for example a business, the cash flows can be projected without regard to the risk of diminution through the disruption of a sale. However, if a sale is reasonably likely at some foreseeable time the valuation should have regard to the estimated sale price as a "terminal value". [Note that, if the cash flows would not ordinarily be expected to be materially affected by a sale then there are no "special benefits" and the value to the owner should reflect the market value at the valuation date].

149. Care must be taken to distinguish personal goodwill from commercial goodwill – see Part G.

Capitalisation rate/ discount rate

150. Again, if special benefits are being valued these should be defined and valued separately. In general is it preferable to apply a discounted cash flow approach (*Sapir, Georgeson, B and B)* but that may depend on the nature and term of any special benefits. Capitalisation may be appropriate if it reasonably assumed the special benefits will last indefinitely (*Ramsay, Best*, *Scott*). Specification should be made of the timing/term of the assumed benefits, whether or not any growth is assumed, and explaining the basis of estimating a discount rate.

151. Where one lump sum is assumed to be received on the accession to control of a company, the valuer should explain the elements of the discount rate as regards assumed growth. That is, the future value of a company [and the shareholders' proportionate interest therein if it is assumed to be linked to the underlying value] cannot logically be the same as the present value, either in nominal dollar terms or in real dollars. Some assumptions must be made about profits, capital growth and dividends/ reinvestment. These should be explained.

152. The application of blanket "flat" discount to net asset backing in preference to a consideration of the specific factors [including marketability and control factors] is fraught with danger – see the comments above on *Turnbull* , *Barouche*, the comments at paragraph 83 above about *AJW and JMW,* see the comments at paragraph 101 above about *Hegarty.*

Lack of marketability and control

153. Mr Zipp suggest that:

"Discounts for minority interest and lack of marketability are relevant only to a willing buyer and have no consideration to an owner not contemplating the sale of the business interest."

154. In a paper[109] delivered in 1996 Darryn Jensen discusses various of the decisions dealt with in this paper including *Sapir* and *Turnbull*. Mr Jensen questions whether any discount at all should be allowed for lack for marketability in these and similar cases. As to the decision in *Sapi*r Mr Jensen says:

"….it is curious that his Honour adopted a valuation which is essentially the price of the shares upon a sale by the wife to her parents. It is true that, if there was to be a sale, the wife's parents would have been the purchasers. Nevertheless, it was extremely unlikely that there would be any sale at all. One cannot help wondering whether his Honour should have ignored the possibility of a sale to the wife's parents and adopted a valuation of the shares which assumed that the wife would retain ownership of the shares indefinitely and eventually acquire 100% of the equity in the family companies. It is questionable, in these circumstances, whether any discount at all should have be (sic) allowed."

155. As to the decision in *Turnbull,* Mr Jensen says:

"Once again, there is a question as to whether the court should have allowed any discount at all. If it is unlikely that the shareholding will ever be sold, lack of negotiability becomes irrelevant. A discount is justifiable solely on the basis that some account should be taken of the remote possibility that a minority shareholder may prefer cash now rather than wait until a time when she or he acquires a majority interest."

156. Mr Jensen concludes:

"Minority shareholders who are prepared to wait for the majority shareholders to pass their interests to them are not burdened with the disadvantages of an outside purchaser in relation to realisation of the interest.

The decision in *Sapir (No 2), Turnbull* and *Harrison* indicate that it may still be appropriate, in cases of this type, to discount the value of a shareholding to allow for the contingency that a minority shareholder may subsequently prefer to convert the shareholding into cash. This is but a minor qualification to the general proposition that shareholdings in family companies are to be valued according to their worth to the owner."

157. It would seem that Mr Jensen is of the view that the value to a non-controlling shareholder is the rateable [pro rate] value of the non-controlling interest. If that is so that would mean that a reasonable person X would be indifferent as between cash of $1 million today and, a 20% interest in a family company with a value today of say $5 million where the controlling shares are held by the parents of X who have a life expectancy of, say,15 years. In this author's opinion, that conclusion is inconsistent with rational commercial behaviour.

158. In this author's view it is reasonable to argue that lack of marketability is of a lesser concern to someone who is not, in the ordinary course, contemplating the disposition of the asset at the valuation date – that is the reasoning in *Scott*, and see also *Dalzeil* [paragraph 127 above]. In the "family company" cases discussed above, the holder has no real choice but to hold onto the assets, but that does not mean that he /she would not prefer to dispose of the asset or may wish to do so before the death of the controlling shareholder. Marketability and minority discounts remain relevant. Again, the valuer looks at value through the eyes of a reasonable person in the shoes of the owner:

a. if the asset concerned is shares in family company and the owner must share control (with for example, one of more siblings) on the death of those in control, that factor calls for a discount – see *Turnbull* (supra);

109 Darryn Jensen, *Valuation of Businesses in Proceedings under Section 79 of the Family Law Act*, (1996) 10 Australian Journal of Family law, at p 224

b. allowance should normally be made for the time value of money and risk. There is always a possibility that a company will suffer ill fortune because of factors which are related to the actions of those in control, rather than ordinary business considerations. If one is valuing a freely marketable company controlled by X today, X can exchange his interest for cash. If he chooses not to do so that does not reduce the present value, because X possesses the power to choose whether or not to sell. But the non-controlling shareholder in a family company often has no power to choose to realise his/her asset [or at least not for any substantial amount]. There is a risk that the controllers will take action which will cause the company [or the shares of the relevant holder] to diminish in value, without the holder having any power to do anything about it;

c. further to b, even if there is no particular reason to assume that those in control will make unusually bad business decisions, the minority holder lacks the option of selling if he or she perceives, for example, [rightly or wrongly] that the business prospects are poor, or that an alternative investment would produce a better return for the same or lesser risk;

d. in the case of the holding of an interest in a professional practice, the holder may at some future time wish to dispose of the interest, [in the partnership case, disposition may be effectively forced by the decisions of other partners]; at such time both marketability and minority issues will assume importance.

e. the fact that the holder customarily acts in concert with the other parties will reduce the risk to him/her below that which would be expected to be faced by a prospective buyer.

159. A concern may be expected that there is an unfairness in valuing assets which are unsaleable, or which are worth more on the basis that they are not sold, or on VTO basis when, by definition this value cannot be realised on a sale. The following responses may be made:

a. if the decision of the court requires a sale of an asset, then the appropriate basis of valuation is market value;

b. the Court has a very wide discretion in arriving at its final orders . The valuation issues are one step along the path. “Fairness” is ultimately a question for the Court assisted by counsel. As the cases discussed above reveal, the finding of a substantial VTO may ultimately have little bearing in terms of an allocation of assets between the parties;

c. what the valuer must do is to bear in mind the duty to the Court enshrined in the Family Court Rules and to take care not to mislead the court about, for example, the significance of the valuation conclusion [ie what exercise he or she is undertaking], what someone might pay for an interest being valued, or what discount rates or discounts might be appropriate in a particular fact situation.

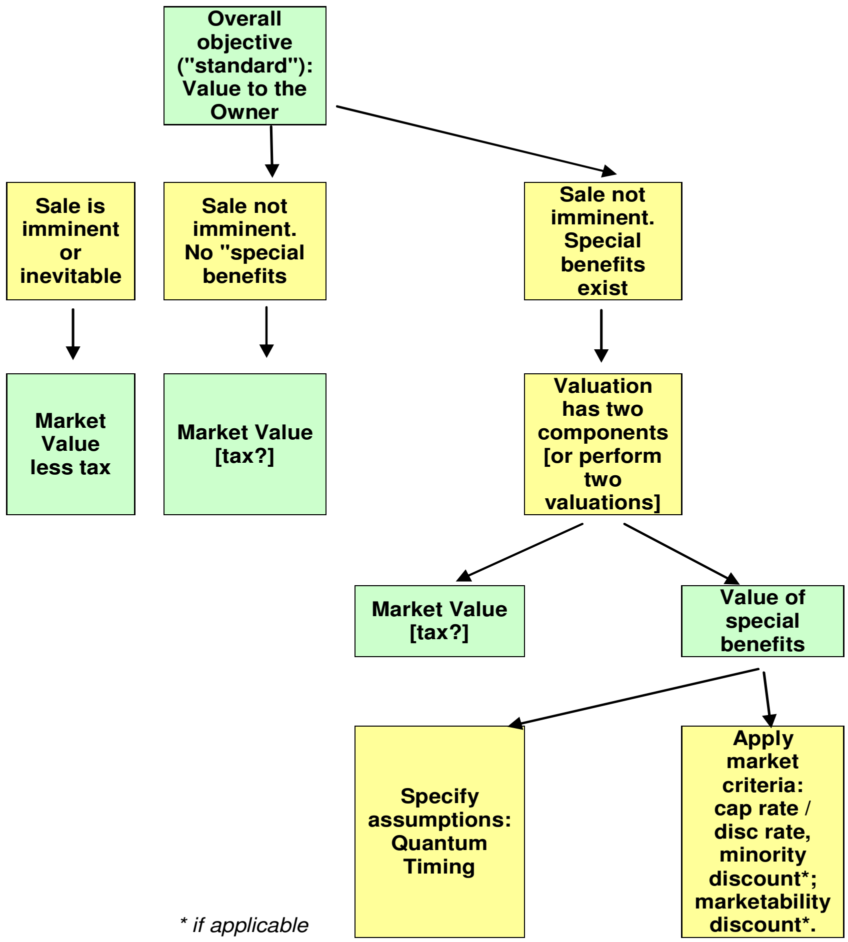
Tax

160. Tax is not considered in detail here. Reference should be made to the decision in *Rosati*[110]. The significance of the decision in *Blake* [see above] is that, if market value (pre tax) is higher than VTO but the court adopts VTO on the basis that the asset is not to be sold, it is not appropriate to allow a deduction for tax.

110 *Rosati v Rosati* (1998) Fam CA 38

PART J: A SUGGESTED FRAMEWORK

161. A suggested framework to assessing value for Family Law purposes is depicted in the following diagram:



162. If a sale is imminent or inevitable as a consequence of the litigation the appropriate basis of valuation will generally be market value (*Blake*), as will be the case if there are no special benefits. In each case the value to the owner is the market value (*Ramsay*). Whether or not there are perceived to be special benefits the valuer should disclose in the report what is his/her opinion about market value [*Barouche*, *Ramsay*). If there are perceived special benefits the valuer should say what assumptions are made about these and what are the implications in terms of a valuation.

163. In fixing either VTO or, the incremental value of special benefits, there are two key steps:

a. The valuer identifies clearly what assumptions are made about the quantum of the benefits and their expected duration. There may be a range of assumptions and a range of calculations proffered to the Court to assist it to determine value once the correct factual basis is proved by evidence (*Ramsay*, *Barouche*, *AJW & JMW*);

b. The valuer then values those benefits by reference to the market criteria (*Barouche*) which the valuer assesses would face not a prospective purchaser, but a reasonable person in the position of the owner. These will determine the discount rate, or capitalisation rate and, if appropriate, any discounts to be applied. It should be remembered that, where what is being valued is a minority interest, discounts for lack of control are usually applied to the value fixed by reference to the value of an equivalent controlling interest and a discount for marketability, if applied separately is conventionally applied against the comparable value of a freely tradable minority interest. If the discount rate or capitalisation rate already reflects these disabilities, no further discounts should be applied.

Disclaimer: ***This paper is in the nature of general comment only. No reliance should be placed upon any particular statement as the basis of making or refraining from making, any decision or applying any particular concept or methodology, The author accepts no liability to any party in respect of the contents hereof.***

APPENDIX A: MARKET VALUE

76 Professional Standard APES 225 Valuation Services, issued by the Accounting Professional and Ethical Standards Board in July 2008. The standard encourages members of professional bodies who have adopted the standard to use as far as practicable terms that are in general use for valuation services. Members are referred in the Standard to the International Glossary of Business Valuation Terms which is included in the valuation standards of the American Institute of Certified Public Accountants and the Canadian Institute of Certified Business Valuators[111].

77 Valuers in Australia commonly use the term “fair market value”. The Income Tax Assessment Act refers commonly to “market value”. Stamp duty is levied on the greater of the consideration for the transaction and the “unencumbered value” of the relevant asset. These terms are generally synonymous and are generally defined in similar terms to those adopted in the International Glossary which defines the term “Fair Market Value” as:

“the price, expressed in terms of cash equivalents, at which property would change hands between a hypothetical willing and able buyer and a hypothetical willing and able seller, acting at arms length in an open and unrestricted market, when neither is under compulsion to buy or sell and when both have reasonable knowledge of the relevant facts. {NOTE: In Canada, the term "price" should be replaced with the term "highest price"}”

78 The International Valuation Standards Committee uses the term “market value” defined as:

“The estimated amount for which a property should exchange on the date of valuation between a willing buyer and a willing seller in an arm’s-length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently, and without compulsion” [IVS1, paragraph 3.1].

79 Australian Accounting Standards commonly use the tern “fair value” defined to mean112: “The amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in a arms length transaction.” Again, the concepts are essentially the same.

111 Why APES 225 refers to the International Glossary and not to the IVSC standards is unclear, although the Glossary is more “business [rather than real estate] specific”.

112 AASB 3, Appendix A