

Aitken & Murphy [2013] FamCA (15/1/13) — Fair Market Value v Value to the Owner

There has been much conjecture as to the applicable adoption of the Value to the Owner (VTO) or the Fair Market Value (FMV) concepts in preparing business valuations for family law purposes and whether or not FMV is the same as VTO in cases where there is sole ownership and a market for the business.

The definition of fair market value is commonly (from *Spencer v Commonwealth* (1907) 5 CLR) defined 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 arm's length in an open and unrestricted market, when neither is under compulsion to buy or sell and when both have a reasonable knowledge of the relevant facts.

This definition clearly assumes that a market exists for the transfer of the business.

The concept of value to the owner was explained in *Scott & Scott* (2006) FamCA 1379 as:

The concept of “value to the owner” considers and takes into account the benefits to a particular owner even though this may not be based on a hypothetical third party purchaser.

Warwick J. in *AJW v JMW* (2002) FLC 93-103 stated:

As I indicated in *Ramsay v Ramsay* (1997) FLC where there is a market for shares, evidence of market value may well be on and the same as “Value to the Owner.”

In the recent family law case of *Aitken & Murphy* [2013] FamCA (15/1/13), Justice Young considered the applicability of Value to the Owner and Fair Market Value.

One of the assets held by the parties in the *Aitken & Murphy* case was a business in the construction industry owned by the Respondent. The strength of the business is very much the personal reputation, experience and knowledge of the Respondent and his operational control. Its perceived weaknesses are said to be, in contrast, its substantial reliance upon the Respondent for securing ongoing work and projects and generally increased competition and the current real estate market and economic concerns. A single expert valued the business on both a FMV and VTO basis. The single expert noted that his preferred valuation approach is a ‘Fair Value’ basis using a CFME approach, given the subjective nature of adopting a ‘Value of Equity to Owner’ basis of valuation.

The single expert was not called for cross-examination.

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In this case Justice Young made reference to the principles outlined at paragraph 24 in *Taylor & Taylor & Taylor* [2000] FamCA 308 the Full Court examined previous reported cases that had established the manner in which a trial judge should approach the task of valuing property of the parties, including:

- 24.1 The determination of valuation issues “...is essentially a matter for the trial Judge” (*Hull and Hull* (1983) FLC 91-360 at 78,410).
- 24.2 The determination of valuation issues may be assisted by evidence of expert witnesses. The purpose of such evidence is to enable the trial Judge to form his or her “...own independent judgment on the matter by the application of the appropriate principles” (*Lenehan and Lenehan* [1987] FamCA 8; (1987) FLC 91-814 at 76,142).
- 24.3 A trial Judge must satisfy himself or herself, by means of the application of proper principles, that he or she has arrived at an appropriate value. If that value “...happens to be different to the values ascribed to the relevant property by the valuers called in evidence, this in itself does not affect the validity of the Judge’s finding...” provided that proper principles have been applied (*Borriello and Borriello* (1989) FLC 92-049 at 77,558).
- 24.4 The determination of the value of property involves a determination of the most appropriate method of valuation, which determination in turn depends on a number of factors. In the case of shares, those factors include “...the purpose for which the valuation is made, the nature of the shareholding, the character of the company’s business, its capacity to earn profits and the net value of its assets” (*Mallet and Mallet* [1984] HCA 21; (1984) FLC 91-507 per Gibbs CJ at 79,121).
- 24.5 It is the shareholding of the party, as opposed to the assets of the company, which must be valued (*Gamer and Gamer* (1988) FLC 91-932 at 76,743).
- 24.6 Whilst the primary test is that of a hypothetical prudent purchaser (*Gamer and Gamer* (1988) FLC 91-932 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).

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Justice Young further noted:

- that **the value to owner concept is intended to bring to account any additional economic benefit which is conferred upon the business owner by his control of the shareholding** and it is intended to include within the value any commercial or financial advantage to that owner which might not necessarily be available to any third party purchaser.
- that whilst there is no suggestion, let alone any evidence, of an intended sale in this case, and thus no third party purchaser, nevertheless the obligation of the Court is to determine a just and proper valuation of the business. Thus **in this case there is truly a hypothetical vendor and a hypothetical purchaser** and the Court must, in that somewhat artificial circumstance, determine a notional value to the Respondent of the business. The essence of the approach by the Court however is that whatever notional value is determined **it must be found to be a real value** of that interest.
- that **he endorsed the previous findings in a number of cases which have highlighted the fact that traditional valuation methods have been developed for commercial purposes and may be inappropriate for the purposes of a Family Law valuation.** So, for example, the Full Court in *Reynolds & Reynolds* (1985) FLC 91-632 said at p 80,111:

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....

In *Turnbull & Turnbull* (1991) FLC 92-258 Baker J said at p 78,738:

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 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.

In *Harrison & Harrison* (1996) FLC 92-682 the Full Court upheld the approach taken to the value of shares by the trial Judge, who had said:

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

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In approving of the observations of the trial Judge the Full Court said, at p 83,087:

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. 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.

In the *Aitken & Murphy* [2013] FamCA (15/1/13) case, Justice Young proceeded on the basis that:

- the Respondent had **sole ownership** and control of the business and that is reflected in a proper valuation of that total shareholding.
- **it would indeed be inequitable to add a further additional valuation**, on the basis of sole ownership, to that value obtained upon a proper multiple adjustment of its future maintainable earnings.
- **he did not value the business on the basis of value of equity to owner, which would have afforded a higher valuation** than that which he determined.
- the Respondent had total control of the business, its shareholding and thus its work and its income. He is central to the business as it is his knowledge, reputation, skills, work performance and his guaranteed satisfactory completion of the project that is at the very heart of his contract with his clients. There are **no minority shareholder issues** or other discounts required to reflect a true value of the shareholding which safely can be valued upon its past and present performance and work history and the skills, reputation and work record of the Respondent.

Interestingly, Justice Young determined not to select either the low or the mid multiple as being appropriate and adopted the higher multiple in the single expert's fair market valuation range.

It would have been interesting to know how the Single Expert defined VTO in his expert report and whether or not it included an element of non-transferable personal goodwill. Justice Young did note that the owner was "*central to the business as it is his knowledge, reputation, skills, work performance and his guaranteed satisfactory completion of the project that is at the very heart of his contract with his clients*".

Whilst we acknowledge that the objective of valuations for Family Court proceedings is to assess the value of the business or shareholding to the party, we consider this is the same as valuing most **marketable / "saleable", solely owned businesses** on the Fair Market Value concept.

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