

Company valuations

Diving into the unknown

NICHOLAS YATES QC

FPR - PD 25D

Single joint experts

2.1 [FPR 25.4](#) applies to a single joint expert ("SJE") in addition to an expert instructed by one party. This means that the court's permission is required to put expert evidence from an SJE (in any form) before the court. However, in family proceedings (except children proceedings) there is no requirement for the court's permission to be obtained before instructing an expert. **Wherever possible, expert evidence should be obtained from a single joint expert instructed by both or all the parties ("SJE").** To that end, a party wishing to instruct an expert should first give the other party or parties a list of the names of one or more experts in the relevant speciality whom they consider suitable to be instructed.

H v H [2008] EWHC 935 (Fam)

104. ... I have already made plain during this judgment my objection to treating the valuation exercise as though it is an exact science which, to adopt again the words of Lord Nicholls, justifies a thorough investigation when such an investigation is not only extremely expensive but also of doubtful utility.

The Mostyn formula

$$A - B/2 = \text{result/award}$$

A = the value of the company now

B = the value of the company when the parties married or cohabited

WM v HM [2017] EWFC 25 (para. 11)

Quoting from The Scottish Case:

"38. I am firmly of the view that the correct approach to give effect to the sharing principle is to try to calculate the scale of the matrimonial property and then normally to share that equally leaving the non-matrimonial property untouched. This is logically pure, morally sound, easy to understand, and limits individual judicial caprice." ...

"I continue to oppose the school of thought that plucks a random percentage out of the air where the pool of assets is a mixture of matrimonial and non-matrimonial property".

WM v HM [2017] EWFC 25 (para. 17)

17. In this case the SJE has valued the company in July 1986 as between £188,000 and £414,000. His approach eschewed any hint of retrospective analysis. He identified (in May 2016, when he wrote his main report) a 540% increase in the FTSE All-Share Sector relevant to this business. That would be about 700% now. Thus, using a strict *Jones* technique he would give a non-matrimonial value of the company of £1.5m - £3.3m.

18. I do not consider that this low bracket begins to reflect fairly the true present value of what the husband brought into the marriage through XG. A linear time [straight-line method] apportionment would suggest that just over 20% (20.12% to be exact) of the present value had been accumulated at the time of the marriage. In numeric terms this is £44.5m.

WM v HM

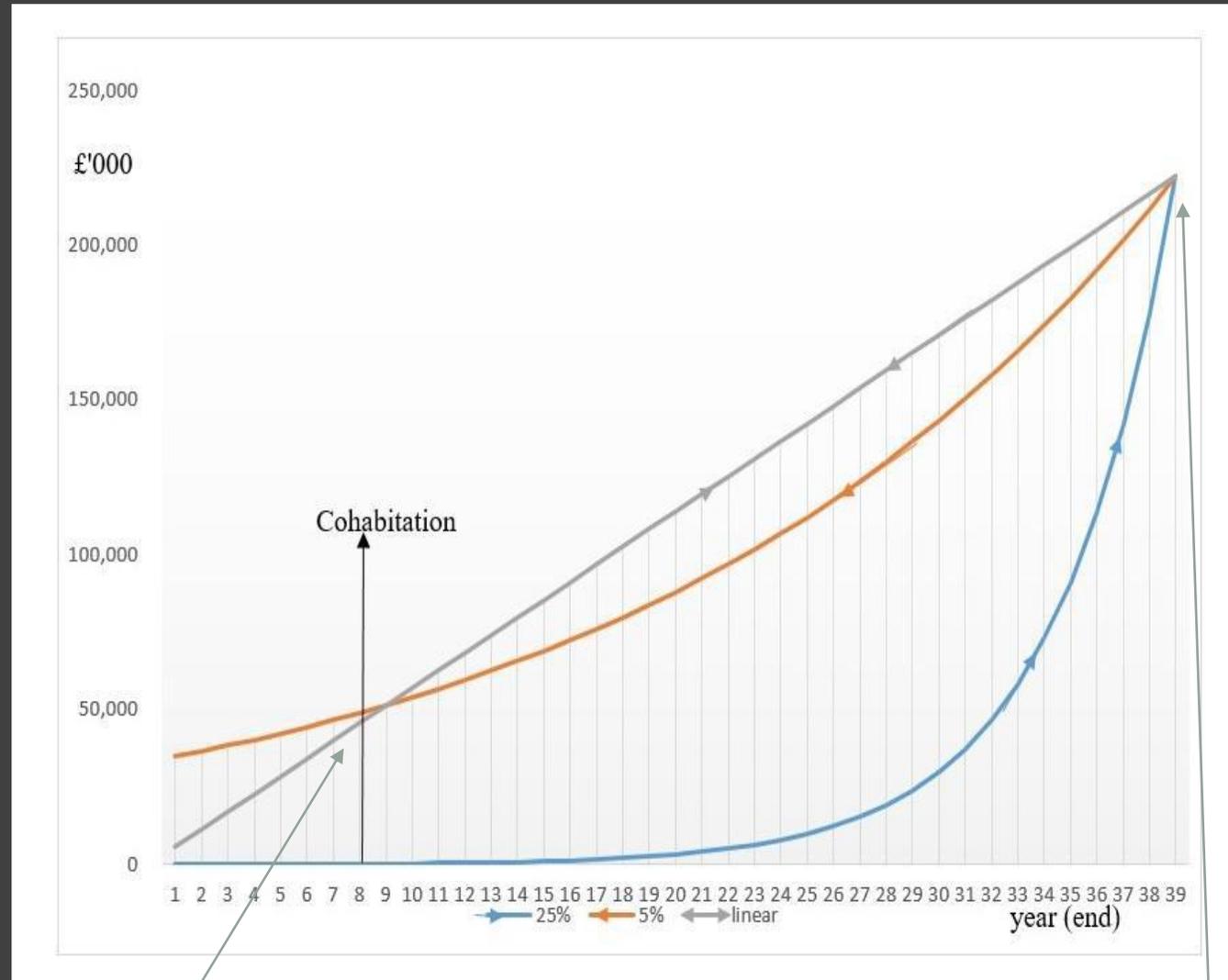
Mostyn J's graph

see para. 19

Mostyn's straight-line method: A linear time [straight-line method] apportionment would suggest that just over 20% of the present value had been accumulated at the time of the marriage. In numeric terms this is £44.5m.

Discount rate of say 5% and work backwards from the current value. 5% has long been thought to be the "natural value of money". Locke thought so in 1722 when writing about interest on an unsecured debt. Using this technique, £221m in year 39 shrinks to £49m in year 8.

Per W: If one were to start with say £46,000 of value and to increase that every year by 25% you would end up with £221m.



Value of the business now: c.£221m.

Value of the business at cohabitation: c.£44.5m

Hart v Hart - what was the case about?

1. This case concerns the approach which the court should take to non-matrimonial property when determining a financial remedy claim by application of the sharing principle. I emphasise that, what I say in this judgment, is confined to this principle. It raises both evidential and legal issues. How is such property to be assessed? What degree of assessment is required? Is the approach formulaic or does the court have a broader discretion?

Hart v Hart: Moylan LJ

14. The central factual issue considered by the judge was the relevance of the husband's pre-marital wealth to the determination of the wife's claim. In considering this issue it is clear that, although the judge referred to every case as being different and as being decided on its own facts, he felt constrained, as he said at the outset of his judgment, to seek to apply the "formulaic approach" taken in *Jones v Jones* [2011] 1 FLR 1723. This led him into a long exploration of the extent of the husband's pre-marital wealth and its value; the manner in which this wealth had developed during the marriage; and the extent to which there had been "mingling". He did this because he wanted, if possible, to obtain a "baseline figure" to use for the purposes of a mathematical calculation as had occurred in *Jones*...

68. Put in simple terms, the court ultimately has to decide, as part of the discretionary exercise, how to weigh or reflect the existence of non-matrimonial property when determining the award. **A key question** which has emerged, and which is engaged in the current case, **is whether this should be undertaken in a formulaic manner or whether the court can adopt a broader approach.**

Moylan LJ's conclusion

84. In my view, the court is not *required* to adopt a formulaic approach either when determining whether the parties' wealth comprises both matrimonial and non-matrimonial property or when the court is deciding what award to make. This is not necessary in order to achieve "an acceptable degree of consistency", Lord Nicholls in *Miller* (paragraph 6), or to achieve a fair outcome. Indeed, I consider that the present case demonstrates the difficulties which can arise if a court strives to adopt a formulaic approach in circumstances where that is not likely to be easily achieved because of the nature of the financial history.

Moylan LJ v Mostyn J

87. In addition, with due respect to Mostyn J's extensive experience in this field, I am not sure there are different schools. In my view, the differences which he identifies are examples of the same principle being applied, but applied in a different manner depending on the circumstances of the case. **One application may be more specific than the other but this will typically reflect the "degree of particularity or generality appropriate in the case": *Miller* (paragraph 27).** The outcome will be the same, namely, when justified, an unequal division of the parties' property.

96. ... In arriving at this determination, the court does not have to apply any particular mathematical or other specific methodology. The court has a discretion as to how to arrive at a fair division and can simply apply a broad assessment of the division which would effect “overall fairness”. This accords with what Lord Nicholls said in *Miller* and, in my view, with the decision in *Jones*.

97. Finally, I would repeat that **fairness has a broad horizon**. I recognise, of course, the need for clear guidance and principles when the court is given a discretion as wide as that contained in section 25 of the 1973 Act. Such clarity not only assists judges when determining financial claims but also enables those seeking to resolve the consequences of their separation and divorce, as it has been described, “to bargain in the shadow of the law”: *Matrimonial Property, Needs and Agreements* 2014 (Law Com No 343) paragraph 3.6. **However, this should not lead to the imposition of constraints which are not needed to achieve, and which deprive the court of the flexibility required to achieve, a fair outcome.**

Martin v Martin [2019] 2 FLR 291

(2) The judge had been entitled to adopt a straight-line apportionment approach when determining what part of the current value of the company had to be characterised as non-marital property. Whether property was matrimonial or not had to be determined in a partly evaluative and partly discretionary manner. The judge had clearly expressed his reasons for using the straight-line approach in his judgment. The approach had resonated with fairness, as it had taken an overarching review of the weight to be attributed to the husband's contributions to the business throughout its existence. **The exercise on which the court was engaged was not restricted to a single route to determining how the wealth was to be characterised for the purposes of the application of the sharing principle. The judge had not relied on the 1986 valuation given by the expert or the turnover/profit graph produced by the wife, because those approaches had not provided a fair assessment of the part of the current value of the company which had to be characterised as non-marital....**

XW v XH [2019] EWCA Civ 2262

The parties were c.50

7 year marriage

A young child who has special needs, looked after mainly by W

W had access to trust assets of her own

The total assets were c.£530m

H was the CEO of a company set up some years before the marriage

That company was sold in 2015/16 generating £370m which, by the time of the hearing (at first instance) had grown to almost £500m

XW v XH: reasons per Baker J (at first instance)

[237] ... the fair outcome is one that departs from the sharing principle and leaves the husband with a significantly greater proportion of the assets. I reach that conclusion for the following reasons.

[238] First, the parties have to a very substantial extent **kept their financial affairs completely separate** during the marriage...

[239] Secondly, **the assets which grew so substantially in value during the latter years of the marriage were the husband's business assets.** The case-law remains unclear as to whether such assets should be regarded as matrimonial or non-matrimonial. In the sense that the growth in value occurred during the marriage, they could be said to be matrimonial. On the other hand, the assets remained at all times in the hands of the husband. They were never pooled. In that sense, they can properly be described as non-matrimonial. Ultimately, the label does not matter. What is relevant, in my judgment, is that they were the husband's business assets...

[240] Thirdly, I am satisfied that there was a latent potential in the company not reflected in the conventional valuation conducted by Mr Kay. The ultimate phenomenal success of the company was due in part to developments and decisions taken in the business during the marriage, but it was also attributable to developments and decisions taken before the marriage – the creation of the company, the putting together of the team, the earlier activities of the company in its field, including the original product models, and the development of a marketing strategy. To a not inconsiderable extent, the later success was built on those earlier foundations. Mr Kay thought that this was not a significant factor in determining the value of the company at the date of the marriage because the subsequent growth in the business did not occur for several years after the marriage. In my judgment, however, the latent potential was there at all material times – it just remained latent for rather longer until the opportunities for growth arose.

[241] **How should this latent potential be taken into account?** To my mind, with great respect to both Holman J and Mostyn J, I consider that neither the approach in *Robertson v Robertson* [2016] EWHC 613 (Fam), [2017] 1 FLR 1174 (treating 50% of the value of the business at the date of sale as having been created prior to the marriage) nor the approach in *WM v HM (Financial Remedies: Sharing Principle: Special Contribution)* [2017] EWFC 25, [2018] 1 FLR 313 (excluding the proportion of value in the business that was created before the marriage on a linear apportionment basis) is appropriate in this case. As Arden LJ noted in *Jones v Jones* [2011] EWCA Civ 41, [2012] Fam 1, [2011] 3 WLR 582, [2011] 1 FLR 1723, the court must try to look as far as it can at the reality of what actually happened rather than proceed on an artificial assumption of a straight-line growth from the date of foundation of the business up to the eventual sale. To insist on a linear or arithmetical approach would be to fall into the error identified by Moylan LJ in *Hart v Hart* [2017] EWCA Civ 1306, [2018] 2 WLR 509, [2018] 1 FLR 1283 of imposing 'constraints which are not needed to achieve, and which deprive the court of the flexibility required to achieve, a fair outcome.' **In this case, adopting Moylan LJ's approach, I conclude that the evidence does not establish a clear dividing line between matrimonial and non-matrimonial property and it is neither proportionate nor feasible to seek to determine a clear line. Instead, I propose to undertake a broad evidential assessment before deciding how the wealth should be divided. My assessment is that there was a significant, though unquantifiable, latent potential in the company at the date of the marriage which is not reflected in the formal valuation. The fact that there was such a latent potential in the company must therefore be taken into account when determining the extent to which there should be a departure from the sharing principle.**

[242] Fourthly, and finally, I am satisfied in this case that the husband's contribution to the growth in the value of the business assets during the marriage comes within the concept of special contribution....

XW v XH: Baker J's decision

[245] In all the circumstances, I have concluded that a fair outcome would be to award the wife a lump sum equivalent to 25% of the difference between the husband's share of the proceeds of sale of the company in 2016 and the value of the husband's shares at the date of the marriage as assessed by Mr Kay, but increased to take account of passive growth applying the MSCI World Technology share index as proposed on behalf of the wife.

XW v XH: Court of Appeal (Moynan LJ)

86. in respect of financial remedy cases, the need for the judgment to explain with sufficient clarity how the award has been calculated. Without this, there would clearly be scope for a party to argue that the judgment is not sufficiently reasoned. As I have said very recently, and since the hearing of this appeal: “Every financial remedy judgment should clearly set out how the award has been calculated”, *Moher v Moher* [2019] EWCA Civ 1482, at [114(ii)].

114. What is being undertaken is a *retrospective* analysis to determine, by making (to repeat) “fair overall allowance” or by giving the weight the court considers just, what part of the *current* value of the asset should be treated as marital property for the purposes of the application of the sharing principle. This is not to attribute value to what Wilson LJ called “the subsequent activity of the diver or gymnast” (*Jones*, at [42]) because that is the product of marital endeavour. However, because the analysis is undertaken with the benefit of hindsight, a court is not bound to adopt the mathematical route adopted in *Jones* based on a prospective valuation as at the date of the marriage (i.e. one that ignores later, known, events). It is well-recognised, but worth repeating, that although the court in *Jones* started with this valuation, the figure was then doubled because the judge had found that there was, what was called, “a springboard in place (which was) not reflected in the valuation”, at [41]. The doubling of the valuation by Wilson LJ was, as he acknowledged, “highly arbitrary”, at [43].

115. In addition, having regard to the judgment below in this case, I think I need to make clear that, when I said in *Hart*, at [94], that the court can “undertake a broad evidential assessment” when there is a “complicated continuum” and “leave the specific determination of how the parties’ wealth should be divided to the next stage”, I did not mean that the court need not identify *at* the next stage, namely quantification of the award, how this factor impacted on the award. The “court does not have to apply any particular mathematical or other specific methodology”, *Hart*, at [96], because, as I said in *Martin*, at [112], there is no “single route to determining what assets are marital”. However, as I also said in *Hart*, at [96], “the court will have to decide ... what award of such lesser percentage than 50% makes fair allowance for the parties’ wealth in part comprising or reflecting the product of non-marital endeavour”. This can be a broad assessment, but when this is the *only* factor justifying a departure from equal sharing, the percentage division will inevitably make plain the court’s decision (because, for example, by awarding the applicant 30% of the current wealth, it will be apparent that the court’s broad assessment was that 40% of the wealth was not to be treated as matrimonial property). I return to this latter issue below.

126. I first propose to consider the overall basis of the judge's award. As referred to above, the judge gave four reasons for departing from the sharing principle. His judgment does not seek to differentiate how each of these impacted on his award. Rather, he decided to give them a cumulative effect reflected in his decision to award the wife a lump sum equivalent to 25% of the growth in the value of the husband's shares based on the value given by the accountant with indexation. Does this approach, in this case, satisfy the need for a judgment to provide sufficient clarity as to how the award has been calculated? Or, as Ms Stone submitted, is the judgment flawed because it does not set out how each factor, in particular in respect of latent potential, "affected his overall calculation of" the award?

158. (ii) Latent Potential Value:

Again for the reasons given above, I consider that the judge was entitled to find that part of the proceeds of sale of the shares was non-marital property to which the sharing principle did not apply. He was also entitled to determine what proportion was not marital property other than by applying the expert's valuation increased by indexation. It was open to him to undertake, as he said, "a broad evidential assessment" and to conclude that there was significant value not reflected in the formal valuation, at [241]. **However, because the judge did not set out his determination of the extent of the marital property in this case, this court is unable to separate out this aspect of his decision for the purposes of deciding whether or not to uphold it.**

XW v XH: Court of Appeal outcome

163. I consider that we are in a position to undertake the “broad assessment”, as explained in *Hart*, required in this case to determine the “fair allowance” (referred to above). It is clear that, as in *Robertson*, the Company had its roots in a business started some years before the marriage, as reflected in the graph in the judgment, at [200]. I would also note that the graph of the Company’s progress in terms of turnover appears to be similar in shape, a J, to that of the company in *WM v HM*, at [18]. **Applying the judge’s determination that the ultimate success of the Company was attributable to “a not inconsiderable extent” to its pre-marriage “foundations” and that they remained a “significant” factor, I consider that it would be fair to both parties to treat 60% of the wealth derived from the shares, of just under £490 million, as matrimonial property and 40% as non-matrimonial. This gives a figure of £293 million for the former and £195 million for the latter. If the former was shared equally between the parties, the wife’s share would be £146.5 million.**

Hart - Implementation

90. It may be, for example, that the external contribution can immediately be seen to be sufficiently insignificant in the context of the case that it warrants no further enquiry... If, on the other hand, the enquiry would require an account to be undertaken of the marriage and/or some other expensive investigation and/or would be of “doubtful utility”, the court could be expected to decide that such an enquiry was neither proportionate nor required to enable the court to achieve a fair outcome...

WH v HM (para. 27)

XG

Value	221,125,000
79.88% marital	176,634,650
less costs of sale	(4,239,232)
less dividend tax on £80m	(30,480,000)
less CGT	<u>(17,369,653)</u>
Net:	<u>124,545,765</u>

WM v HM (para. 26)

26. The second consequence is that in calculating the net assets the latent tax has to be assessed on the basis that a very large dividend is paid in order to give the husband the means to pay the wife a substantial lump sum, while at the same time allowing him to continue working in and on the business. The dividend tax rate of 38.1% is higher than the capital gains tax rate of 20%. This means that the overall net value of the assets is slightly less than it would have been on a notional immediate sale, and that the value of the wife's share is correspondingly less. I am not disconcerted by this in the slightest. **If somewhat more tax is paid, or taken to be paid, because I have decided that it is fair that the husband should be allowed to continue with this business, then that is a consequence that the wife will have to bear.**

Wells v Wells Thorpe LJ:

[24] Having read the skeleton arguments and the judgment we were at once struck by the security of the result that the wife had achieved in contrast to the risks confronting the husband's economy. The family's standard of living has throughout been dependent upon the fortunes of the husband's business. Had the marriage survived the family would undoubtedly have shared adversity as it had shared prosperity...

In principle it seems to us that the separation of the family does not terminate the sharing of the results of the company's performance. That is easily achieved in any case in which the wife's dependency is met by continuing periodical payments. It is less easy to achieve in a clean-break case. In that situation, however, sharing is achieved by a fair division of both the copper-bottomed assets and the illiquid and risk-laden assets. After all, the wife was already a shareholder in Soundtracs and a substantial increase in her shareholding would at least have enabled her to participate in future prosperity by dividend receipts or capital receipts on sale or a cessation of trade.

WH v HM Motsyn J (para. 29)

“I am aware that in *Chai v Peng & Ors* Bodey J divided the “kitty” 60:40 in favour of the husband because the wife’s award would be largely cash or easily realisable assets: see para 140. I do not adopt that approach. A valuation of an asset is the estimate of what it will sell for now. If it is perceived as being hard to realise then its value will be discounted to reflect that difficulty. It does seem to me to use discounted figures and then to move away from equality is to take into account realisation difficulties twice. Whatever the asset the only difference between it and its cash proceeds is, as Thorpe LJ once memorably said, the sound of the auctioneer’s hammer.”

Martin v Martin: Wells v Wells principle

(1) ... The judge had failed to consider whether his proposed award had achieved a fair division of both the copper-bottomed assets, and the illiquid and risk laden assets. **He had erred in basing his conclusion that there had been no difference between the valuation of the company and its cash proceeds on sale, on the auctioneer's hammer analogy.** That reference was inapt to the circumstances of the case; there was a difference of substance between the value ascribed to the company and other assets including the cash to be extracted from the company by way of dividend.

WM v HM (para. 24)

24. ... Therefore, but for this divorce I proceed on the footing that it was the husband's intention to cash out at that time – seven years from now. Of course, the divorce alters everything. However, it is my judgment that it is reasonable for the husband to be able to continue with his life's work if most of the wife's award can be provided now either by transfers of real property or in cash. **Generally speaking, a *Wells* sharing arrangement should be a matter of last resort, as it is antithetical to the clean break. It is strongly counterintuitive, in circumstances where one is dissolving the marital bond and severing as many financial ties as possible, that one should be thinking about inserting the wife as a shareholder into the husband's company. Its inaptness was well illustrated when Mr Marks QC put it to the wife that a form of *Wells* sharing would have happened had the marriage continued, to which her pithy response was "but it hasn't continued". However, *Wells* sharing is not so objectionable if it only applies to a minority element of the claimant's award.**

WM v HM (para. 25)

25. Therefore, it is my central finding that if most of the wife's award can be provided to her now, or soon, it is not unreasonable to proceed on the basis that the business will not be sold until the husband chooses to sell it. This finding has two consequences so far as the wife's award is concerned. First, and obviously, and as I have already mentioned, it means that a minority part of the wife's award will be expressed as an enlarged shareholding in XG. For reasons I will explain the wife's shareholding will be enlarged from 1% to 17.5%. This is about 26% of her overall award, which is a not unreasonable proportion.

N v N (Coleridge J)

However, I think it must now be taken that those old taboos against selling the goose that lays the golden egg have largely been laid to rest; some would say not before time. Nowadays the goose may well have to go to market for sale, but if it is necessary to sell her it is essential that her condition be such that her egg laying abilities are damaged as little as possible in the process. Otherwise there is a danger that the full value of the goose will not be achieved and the underlying basis of any order will turn out to be flawed.

The bullet points

1. Consider experts on both sides
2. Be aware of the trend towards indicative valuations
3. Save for Mostyn J, there has been a move away from a formulaic approach to dealing with valuing non-matrimonial assets BUT that should now be firmly in retreat post *XW v XH*
4. Beware of the fiscal implications of extracting value from a business: CGT and DIV tax
5. An outcome of part shares and part cash appears to be permissible as an option of last resort
6. Sale, or deferred sale, of companies is more in vogue and may get explicit High Court imprimatur soon
7. Judges will drive down valuations, if the outcome and fairness of a case so dictates (Judges often start at the end and work backwards)

Good Luck!

Nicholas Yates QC