Valuation of private company shares in Family Law proceedings

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The value of shares in a private company will, to a large extent, depend on the value of the underlying business or assets and thus the principles concerning the valuation of unlisted shares can equally be applied to sole traders and partnerships.

See for example authorities referred to by the Full Court of the Family Court in Ramsay (1997) FLC ¶ 92-742

In that case, (one involving the valuation of a minority share holding in a Family Company) the Court held that:

1. *Statements that the purpose of valuation of a party's shares in a family company is to ascertain the value of the shares to the shareholding party, rather than their commercial value or their value to a hypothetical purchaser, when coupled with statements that the value must be "realistic" , may cause confusion. The "value to the shareholder" , often differs from the "realistic" value by including a strong "notional" aspect, taking into account a number of assumptions regarding the receipt of benefits, and disregarding the lack of realisable value.*
2. *There has been insufficient discussion of and differentiation between those factors relating to a subject shareholding of which valuers ought take account in their assessments and those factors, the import of which ought be left to the discretion of the Court.*
3. *The following observations may be made regarding the purpose and method of valuation in family law proceedings:*
    a) *Expert evidence may be admissible in relation to the question of whether there is a market for the shareholding.*
    b) *If there is a market, evidence of the market is highly likely to be relevant, even if there is no intention to sell.*
    c) *It is unhelpful for valuations to focus on the lack of a market in establishing a value to the shareholder. An allowance for lack of realisable value is best determined by the Court, having regard to all of the circumstances.*
    d) *Where no realisable assets exist, the lack of market value will usually be critical.*
    e) *If there is any prospect of the minority shareholding party gaining control of the company, the probability of that event is a question for the Court. The valuers ought only be concerned with the value to the party if they remain a minority shareholder and if they gain control.*
    f) *Questions of the probabilities of particular benefits being received by a shareholding party in the future should be determined by the Court. However, valuers ought assess the value of the shareholding on the basis that the benefit is received and on the basis that it is not.*
4. *The lack of realisable value in the husband's shareholding must be recognised by the Court. Having regard to all of the circumstances, it was appropriate that the wife's share of the property of the parties be discounted by 10% to take account of this fact.*

The valuation of unlisted shares is clearly one of the most difficult areas of valuation for Courts hearing property settlement cases. A company can operate a range of ventures from retailing to investment. The importance of obtaining a clear understanding of the methods and thence an accurate valuation in cases where shares in a company represent a major or only asset of the parties cannot be too strongly stressed. As was noted by *Cohen* J in *Duffy v Perry* (unreported New South Wales Supreme Court, 23 July 1986):

> *"Despite the obvious importance that the question of values was going to take in the matter valuations were only obtained by both parties on the day before the hearing and indeed they were only completed on the first day of the hearing. Both of them show signs of the extreme hurry in which they were prepared. "   (p 8)*

Cohen J went on to say:

> "*Considering that the plaintiff is seeking the payment of a large sum of money as representing her interest in the company it seems extraordinary that so little concern has been paid to the essential aspects of the valuation. "   (p 12)*

Many of the most important cases concerning valuation have been decided concerning the valuation of estates for the purposes of death duties. More recently, cases decided under the *Family Law Act 1975 (Cth)* provide useful examples of the available methods. However, although these cases give some guidance, valuations under the *De Facto Relationships Act, 1984 (NSW)* clearly still remain at the discretion of the trial Judge. Valuation, especially of unlisted shares, sole traders and partnerships, is like real estate, very much a matter of opinion as much as calculation.

The various ways real property and shares were valued was examined by the New South Wales Supreme Court on the termination of a de facto relationship of 11 years: see *Molina v Fajwul (1994) DFC ¶ 95-151* .

The Court went into considerable detail in the case of the valuation of shares in the private company involved. It looked at the items which covered the valuation of the shares and some loan funds. These included:

a) director's remuneration;
b) rent provision;
c) capitalisation rate;
d) loan due to the defendant; and
e) years to be taken into account in assessing future profits.

The New South Wales Court of Appeal unanimously rejected the appeal by the de facto husband in *Fajwul v Molina* unreported 8 August 1996. They held that the trial Judge had made no error going to the exercise of discretion shown or to be inferred.

As the term implies, an unlisted company is one the shares of which are not listed on an official stock exchange. A family company, the number of shareholders of which is restricted, is generally an unlisted company. On the other hand, a public company, the number of shareholders of which is only limited by the extent of authorised capital, is often a listed company.

There are many examples of companies which are either owned or controlled by one person or a family and, as a result, there are few transfers of its shares. An established market does not exist for its stock and even when there are sales at irregular intervals they are unlikely to be representative transactions which fairly indicate the market value of its shares.

The valuation of the shares of an unlisted company leans heavily on common sense and informed judgement. When valuing shares ideally the object is to determine a price on which a purchaser and seller, both informed and willing, would agree.

It is unwise to attach too much weight to the prices of shares of listed companies in the same or a similar line of business to that of an unlisted company. The potential purchaser of shares of an unlisted company may be expected to invest cautiously. For these reasons alone it is dangerous to draw too definite conclusions from the price-earnings ratios of listed public companies with a view to applying them to unlisted companies.

A controlling interest in an unlisted company is generally valued either on the basis of capitalised earnings or profits or on the basis of asset backing or what could be expected to be realised on liquidation. The essential problems involved are readily isolated; in the case of the earnings or profits basis, it is the choice of a capitalisation rate and in the case of the asset or liquidation basis it is to estimate the realisable values of the company's assets. Of the two, the choice of a capitalisation rate is usually the more difficult. Dealt with below are the various methods used in determining the value of shares in unlisted companies.

The methods of valuation are:

(1) Actual sale price of parcels of the same shares in a bona fide sale at proximate date.

(2) Capitalisation of estimated future profits (ie profit basis).

(3) Capitalisation of expected dividends (ie dividend basis).

(4) Asset value.

(5) Liquidation basis.

Normally, even where it has been decided to use one of the methods above, it is desirable, where possible, to check the results with a value obtained by another method.

If a company is sufficiently profitable and asset rich there may be justification in obtaining two independent expert opinions on the value of the shares as substantial variations can occur in opinions.

In most cases these methods of valuation should be sufficient. There are occasions, however, where, because of the peculiarities of a particular company, a valuation on the accepted methods gives a result which does not reflect the true value. One such case is that of a company with a low asset value but which has a particularly high earning capacity. If the capitalisation rate of similar listed companies is applied, the result is sometimes rather remote from what appears to be reasonable value. In such cases an asset value plus an appropriate amount to cover goodwill may be resorted to in order to arrive at a reasonable rate.

In *Parker v Parker (1993) DFC ¶ 95-139* , the New South Wales Supreme Court stated that the proper time to value assets was at the date of the hearing. Shares were therefore valued at that time and on an arm's length basis rather than at any special value to the defendant. When shares are valued on a capitalisation of future maintainable profits, it was necessary to take commercial matters into account.

The plaintiff, a de facto wife aged 31, changed her name to that of her de facto husband aged 50. The couple lived together for seven years from 1984 to 1991 and had two children born in 1985 and 1988. At the time the couple met, the woman had very little training or work experience. The male defendant for many years gave every indication of being very wealthy and the couple lived an appropriate lifestyle. The de facto husband's assets were in shares in various companies he owned. The Court considered five matters of principle in relation to the valuation of the defendant's property:

1. At what date should a valuation be made?
2. Should the value of the defendant's shares be taken as their value to him or their value to a willing but not over-anxious arm's length purchaser?
3. Was there any place for the principle that property should be valued according to its highest use in this sort of case?
4. Was it appropriate to take commercial factors into account in making a valuation?
5. Should any inference be drawn from absence of full disclosure?

The Court considered the value of the de facto husband's property, the value of the de facto wife's contributions and the extent of the benefits she had received. It then looked to whether the amount arrived at would be just and equitable taking into account the de facto wife's reliance on the relationship and the reasonable expectations that a person in her position would have held. The Court held that:

1. the appropriate time to value the assets was at the date of the hearing unless there were other factors involved;
2. the shares were to be valued on an arm's length basis rather than attributing to them any special value to the defendant;
3. there was no place in the present case for the principle that the property should be valued according to its highest use;
4. when shares are valued on a capitalisation of future maintainable profits it was necessary to take commercial matters into account; and
5. the principle that the Court was entitled to award a higher percentage of disclosed assets on the basis that the probabilities were that the defendant had undisclosed assets was not attracted in this case.

The Court also took into account the community expectation that the domestic partner of a wealthy and successful businessman who had borne him two children would have a home provided by him. The amount finally awarded to the de facto wife was $275,000 to be paid after she had returned specified items of the defendant's property. See *Parker v Parker (1993) DFC ¶ 95-139* .

The choice of the appropriate method of valuation depends on a number of considerations. In *Mallet v Mallet (1984) FLC ¶ 91-507* , the High Court was called on to consider the value of shares in private company, for the purposes of a property dispute under the *Family Law Act 1975 (Cth)* .

The Court noted at p 79,121 that:

"What is the most appropriate method of estimating the value of shares in a proprietary company depends upon a variety of factors. They include the purpose for which the valuation is made, the nature of the shareholding, the character of the company's business, its capacity to earn profits and the net value of its assets. It has been said that a valuation based on earning capacity is generally most appropriate because the hypothetical purchaser of shares in a company which is a going concern is looking, not to a winding up, but to the profits which will ensue from the company continuing to trade (McCathie v Federal Commissioner of Taxation (1944) 69 CLR 1 ; Abrahams v Federal Commissioner of Taxation (1944) 70 CLR 23 ; Commissioner of Succession Duties (SA) v Executor Trustee and Agency Co of South Australia Ltd (1947) 74 CLR 358, at pp 361-362). But it has been recognised that valuation by reference to assets backing or a liquidation basis will be appropriate where earning capacity provides no real measure of the true share value (The Commissioner of Stamp Duties (NSW) v Pearse (1951) 84 CLR 490) or present overwhelming difficulties (Elder's Trustee and Executor Co Ltd v Federal Commissioner of Taxation (1951) 96 CLR 563 ; Jekyll v Commissioner of Stamp Duties (Q) (1962) 106 CLR 353) or where the shareholding is such as to enable the holder to bring about liquidation of the company (New Zealand Insurance Co Ltd v Commissioner of Inland Revenue (1956) NZLR 501). See generally the judgment of Gibbs J in Gregory v FC of T 71 ATC 4034; (1971) 123 CLR 547 .

There is always the risk that in examining methods of valuation attention is diverted from the object of the exercise, namely the ascertainment of the real value of the shares, to the means by which the object is to be achieved. As a general proposition the valuation by means of capitalization of profits is appropriate to those cases in which the likely purchasers will be looking to the profits which the company will earn as a going concern. Where, however, the valuation of the shares as calculated by reference to their assets backing substantially exceeds their valuation as calculated on a capitalization of profits, the former is to be preferred, subject to a discount for the expenses of winding up and distribution, unless there is some good reason for preferring the latter, as, for example, where the shareholding to be valued is a minority of shareholding and those in control of the company intend to carry on its business because that course has advantages for them. Even in such a case it will be proper to take some account of the assets backing of the shares in order to reflect the possibility that those in control of the company might be minded in the future to sell their shares or to realize the value of the assets of the company. "

The need to be conscious of drawing a realistic value, no matter which method was used, was shown in *Bowman and Bowman (1984) FLC ¶ 91-574* . In that matter, which concerned the valuation of shares in a private company, *Nygh* J stated that:

"*In the circumstances I consider it proper to take a composite figure of $70,000 representing the equity of the Horsfield Bay property and the capitalised figure of $43,450 representing the value to a potential purchaser of the business of the company. That such an approach, taking account of both factors, is legitimate, is indicated by the remarks of Mason J in Mallet v Mallet."*

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About the Author

Richard Maurice holds degrees in Law and Economics from Sydney University. He works as a Barrister & Mediator in Family Law financial and parenting matters.

He was admitted in 1984 and worked in private practice as an employed solicitor in a general practice and later for the Federal Attorney General's Office representing disadvantaged clients and as a duty solicitor in the Family Court, in NSW State Children's Courts and in many NSW Local Courts.

In 1988, he was called to the private bar. Since then he practiced mainly in the areas of Family Law, De facto relationships and Child Support, together with Wills and Probate.

He has appeared in a number of significant Family Law cases including seminal cases on Family Law and De Facto property division like Pierce and Pierce (1999) FLC 92-844 and Black v. Black (1991) DFC ¶ 95-113 and Jonah & White [2011] FamCA 221 and more recently Sand & Sand [2012] FamCAFC 179 and Vega and Riggs [2015] FamCA 797.

He completed the LEADR mediation course on 2006 (taught by Sir Lawrence Street) and a refresher course at the Resolution Institute in 2024. He is a member of the Family Law Section of the Law Council of Australia, is registered with the Civil Mediation Council (UK) and member of the International Society of Family Law. He is an Australian NMAS Accredited Mediator.

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