The Risk of Double Counting the Value of a Business

In **Nettler [2007] FamCA 1374** Judge Coleman dealt with the inconsistency of valuing a business on a 'highest and best use' basis which assumed its sale and then being asked to make a future financial needs adjustment based on the disparity of the parties' earnings when the income of the higher earning party was derived from the business. **(This decision was upheld on appeal by the Full Court in Nettler [2009] FamCAFC 185)**

The Judge recognised that the valuation which the Court determines for a company has a significance beyond simply the identification and quantification of the parties' property where its assets are inextricably linked to a business venture which is ongoing and likely to be relied upon as the source of one party's future income.

In 1998 the parties established a mortgage broking business. The wife ran the business which was operated by a company of which they were both shareholders. The most substantial issue in their financial settlement related to the value of the business. The wife's valuation expert valued the business at $323K compared to the husband's expert who valued it at $657K.

The crux of the difference between the valuations related to how the 'loan book' of the mortgage broking business should be treated given the husband's valuer contended that the true value of the business was derived by adding the net tangible assets of the company ($313K) and the value of its loan book ($344K).
While the wife's valuer initially contended that the loan book added no value to the business and was properly reflected in his valuation of $323K, he conceded under cross-examination that there was a market in which loan books are sold and that the company could sell the loan book for a substantial sum and still continue to trade.

However the sale of the loan book would have significant revenue implications for the company and impact on the wife's income given she would effectively have had to re-start the business from scratch if the loan book was sold. The difference was essentially between the company being 'cashed-up' (as a consequence of the sale of the loan book) with substantially reduced revenue, or retaining the loan book and being substantially less 'cashed-up', but with its earnings base maintained.

Regard needed to be had to the evidence that the wife's income and future income earning capacity would be substantially reduced if the loan book was sold.

Conversely, if the lower valuation of the company was preferred notwithstanding the reality that the loan book could be sold, the implications of the wife having an asset which she could liquidate for a substantial sum or continue to derive substantial remuneration from while she refrained from doing so would also have to be taken into account.

Had the Court opted for the lower valuation, which it ultimately considered inappropriate, there would have needed to be a significant adjustment by virtue of the disparity of parties' earning capacities given the wife's earnings were more than double those of the husband, and likely to remain so into the future.

Given the Court in fact adopted the higher valuation based on a 'highest and best use' valuation, the issue to be addressed was the unreasonableness of using a valuation of the company which assumed the sale of its loan book and to then make a future financial needs adjustment based on disparity of earnings because the wife intended to retain the asset. To do so would have been potentially unfair to the wife as her greater earning ability depended upon her not realising any of the income generating assets of company.

In the circumstances of this case having regard to the realities and implications of accepting the higher valuation of the company, a future financial needs adjustment in favour of the husband would have been inequitable.

The Judge concluded that it was unrealistic and unreasonable for the husband to claim an adjustment in his favour in the division of the matrimonial asset pool on the basis that the wife earned twice what he did when he had successfully argued that the company should be attributed a value based on a highest and best use valuation when that assumed the sale of its loan book which was the primary source of the wife's substantial income.