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The 'Value to the Owner' Objective and its Implications in the Separate Recognition of Personal and Enterprise Goodwill

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In the absence of holistic theoretical direction, The Family Court of Australia has attempted to clarify the valuation objective for its purposes, articulating the value to the owner concept. This concept is not exclusive to one legal jurisdiction, however, its application to family law matters continues to cause debate amongst practitioners with regard to its appropriate objective. Born out of minority shareholder issues, this paper reflects on the gestation of value to the owner through reviewing the Court's guidance. It is noted, that there is some tension with this objective when applied to professional services businesses. It is important to resolve the tension properly in order for the court to balance its decisions with respect to the distribution of marital assets and provision for the future needs of family members.

This paper explores a particular application of value to the owner in professional services businesses where the distinction between personal and enterprise goodwill can be at issue. The importance of this distinction is in the consideration of capitalisation of future income as property or future income as enabling financial capacity, but not both. This distinction has implications in Court decisions that apply section 79 and/or section 75(2) of the *Family Law Act 1975 (Cth),* such that, duplication is avoided. Further implications flow to a broad range of valuation assignments where enterprise and personal goodwill components demand separate attention.

Keywords
Value to Owner, Valuation, Goodwill, Forensic accounting.

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In the absence of holistic theoretical direction, The Family Court of Australia has attempted to clarify the valuation objective for its purposes, articulating the value to the owner concept. This concept is not exclusive to one legal jurisdiction, however, its application to family law matters continues to cause debate amongst practitioners with regard to its appropriate objective. Born out of minority shareholder issues, this paper reflects on the gestation of value to the owner through reviewing the Court's guidance. It is noted, that there is some tension with this objective when applied to professional services businesses. It is important to resolve the tension properly in order for the court to balance its decisions with respect to the distribution of marital assets and provision for the future needs of family members.

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JEL Classification: K42, K41.

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Introduction

The debate as to what extent valuation practice is an art or a science rages amongst practitioners and, indeed, the courts because there "will always be an esoteric mix of factors to interpret" (Gilbertson, 2001; Titman and Martin, 2012). Many valuation practitioners[2] shun consideration of valuation theory, believing it to be an abstract diversion from a very practical activity, and, perhaps, with the historic failure of accountants to develop a theory of measurement in their minds. At best, valuers tend to rely upon a market value theory of 'replacement value' based upon the economic principle of substitution where "one would not pay more than one would have to pay for an equally desirable alternative" (Pratt, 2005, pxxxii). This 'theory' provides limited use in justifying a valuation in circumstances other than where an active replacement market exists, or where an asset is put to market.

However, valuation expertise, as recognised by the courts in the role of an expert witness, did not miraculously materialise without the techniques and tools valuers employ having been devised in a systematic and orderly manner. Whilst the courts have no role in providing a theoretical interpretation of valuation practice, their gatekeeper role for the admission of expert evidence has influenced professional valuation processes. An expert valuation witness, by definition, claims to have expertise or specialist knowledge in valuations beyond that of an average person. That body of knowledge is usually developed by training, education experience or skill supervised under professional accreditation. Whilst the valuations expert has a body of peer recognised knowledge to draw upon; it mainly resides in the methods of establishing the monetary value of what is being valued, rather than being contextualised within a theoretical framework, or to the purpose or objective of the valuation.

The absence of a recognised theory of valuation, gives rise to a professional and academic dilemma, with valuations lacking consistency and that potentially damage professional credibility. Lawson (2008) points out "the problem is compounded from a misunderstanding between concepts, doctrines, and various economic theories, …… heightened through a misunderstanding of the role of the courts when attempting to resolve a dispute"[3] Smith (1986) refers to the inconsistencies in appraisal[4] and real estate valuation, highlighting the effects of inconsistencies in valuations, stating that:

> The corollary is, of course, that their continued occurrences weaken appraisal and the appraisal function. They may lead to inaccurate value conclusions, disparities

[2] This paper focuses on the valuation of business entities rather than real property. Therefore, the definition of valuers for this paper is in the context of those specialist accountants who deploy accounting practices for valuation. In this regard, a person directing this deployment, within the legal process, is recognised as an expert to do so, subject to some legal qualification. An expert witness is a person who is retained as a specialist in a subject for the purpose of providing his/her expert opinion on an aspect of the case. Such people may become an expert witness, if they are qualified in their area of expertise, training and specialised knowledge as recognised by the Court. The purpose of expert witness testimony in Court is to assist the trier of fact with regard to the Court's decision and not to make the ultimate decision. The expert witness presents their opinion to the Court in accordance with the Expert Evidence Practice Note.
[3] Lawson was referring specifically to real estate appraisal and valuation, however, his comments pertain to the wider study of valuation.
[4] The International Glossary of Business Valuation Terms 2001 refers the definition of appraisal and related terms such as appraisal approach to the definition of valuation and valuation approach.

> among appraisals, and lowered public confidence in appraisers. Most of the alleged inconsistencies cited in this paper can be easily corrected intellectually.
> ….. Whatever the source may be, inconsistencies result from a breakdown in logic, and they may lead to inaccurate and disparate appraisals.

Jaffe and Lusht (1985) go further noting:

> When a group of individuals cannot decide upon its own purpose, it is to be expected that the group might have difficulty convincing others that its body of knowledge deserves the acclimation of a "profession". Clearly, the lack of a theory of value precludes a precise measure of worth.

In his discussion of accounting theory, Gaffikin (2008) points out that in taking actions, such as determining a valuation, "we would like to be confident that they will in fact lead to desired aims being achieved, but we can never be certain that they will. Therefore, we need to be able to understand the factors that will impact on our decisions: we need to have a soundly reasoned basis for our decisions, and this is where theories come in." Lisey, Langley and Mahoney (1985) point out that "Theories impose order on our observations, explaining how things we see bare, are linked together. Without theories, we would have only a mass of meaningless observations. The choice is not between theory and observation but between better or worse theories to explain our observations. (p7)"

Expert valuation witnesses are people who can offer opinions in court because of their unique and recognised experience, education, training or practice (*Uniform Evidence Acts*, ALRC Report 102, 9.26). Theories provide the rational grounding for this professional recognition, assisting articulation and understanding beyond the field of expertise, in turn, extending informative, active communication through the understanding and explanation of facts, in a valid speech act to the court and community (Habermas, 1984a). Valuation expert evidence, has, however, developed, not from sound research-based theory, incorporating the proving or disproving of a hypothesis, but largely from the guidance found from the courts and the general practice of a body of quantitative methods, not necessarily unique or applicable to any particular valuation purpose. Advice in the form of Accounting Professional and Ethical Standards Board (APES) 225, Valuation Services provides professional context and clarifies obligations for valuers, but falls short on any epistemological or methodological direction. More recently, the International Valuation Standards (IVS) (2017) have expanded the discussion to include considerable direction with regard to the deployment of valuation methods (IVS 105, Valuation Approaches and Methods). As a contribution to better methodological certainty of valuation opinions, IVS 104 advises on the Bases of Values. The other IVS standards that delve into valuation method advise that deciding on the basis of value is a pre-emptive step, to be concluded prior to the consideration of valuation approaches, methods and other detailed applied valuation tasks (for example, IVS 105, IVS 200, IVS 210, IVS 400, IVS410 and IVS 500).

This paper reviews the gestation of valuation evidence, specifically in terms of the expert witness role in advising the Family Law Court of Australia. It recognises a socially constructed ontology espoused by the court under the value to the owner concept as distinguished from the more realist ontology of 'fair market value', which is perhaps more readily understood by the lay person. The social construction of the value to the owner concept is researched through its evolution from questions asked of Spencer's (1907) case, when the "hypothetical, willing but not anxious purchaser and vendor" principle was used in the marriage of Reynolds (1984). Discussion proceeds to consider the learned judiciary's guidance in cases such as Hull and Hull (1983), Sapir and Sapir (No 2) (1989), Turnbull v Turnbull, Ramsay and Ramsay (1997), Best and Best (1993), B&B (No 2) (2000) and eventually to the consideration of professional intangible assets in Wall and Wall (1999). More recently the matter of valuation context in family law has again been considered in Padnall v Padnall (No 3) (2014), Morrow v Steele (2015), Riley v Riley (2016), Aitken v Murphy (2013) and Pope v Pope (2012).

Vella (2009) highlights that the concept of value to the owner is "potentially very confusing for valuers" citing "the blurring in many decided cases of the distinction between market value and value to the owner", between Family Law and non- Family Law cases, as well as transitioning the application of valuation principles in the accounting sense into the Family Law context. Further, the value to the owner concept advises the epistemology. That is, the obtaining of knowledge and the court's guidance with regard to the 'rules' by which to validate the knowledge that contributes to the valuation under the value to the owner objective. Value to the owner is not a theory as it does not lead to a provable, or otherwise testable, hypothesis. Instead, it is a normative objective. This ontological and epistemological consideration clearly differentiates the value to the owner concept as a more senior consideration than both valuation methodology (that is, the professionally recognised patterned principles applied to valuation) and valuation methods (the deployment of calculation rules), a clarity often not recognised by practitioners. The value to the owner concept connects the proper valuation knowledge that arises from the facts of each case. Validation of this connection is required before consideration of the appropriate patterned principles that would be supported by the valuation profession as their generally agreed approaches to the deployment of the rules that underpin each set of valuation calculations and therefore numeric outcomes.

Gaffikin (2008) advises that methodology "investigates and evaluates methods of inquiry and thus sets the limits of knowledge". Fargher (2017) refers specifically to professional patterned principles that underpin the broad acceptance of a professionally accepted statement or communication. Therefore, this paper, on accepting the validity of the value to the owner objective, and guidance from the court, reviews some of the components of methodology that determine the techniques and tools used to define the general valuation approach as deployed to determine the value indication of a business, business ownership interest, security, or intangible asset. Specifically, the paper recognises the difficulty in applying the value to the owner objective of valuing professional services businesses within the Family Law context. It should be recognised that the social construction of the value to the owner ontology has evolved through court decisions that include nuances, such as, undefined reference to 'realistic' outcomes (Warnick J in Ramsay, 1997), decisions based on intuition (Fitzpatrick v Cheal, 2012), the consideration of the owner's personal work intentions (Nettler and Nettler, 2009), the inappropriate segregation of intangibles and the inconsistent consideration of timing effects.

Methodology before Method

Recognition of the higher level objective, then consideration of the methodology, before selection of the appropriate valuation method, is particularly important with reference to the court's decisions under section 75(2) and section 79 of the Family Law Act (1975). Subscribing to the value to the owner ontological objective "is not an invitation to abandon principled methodology." (Moore J. in Barouche, 1999).

For example, methodological consideration of personal and enterprise goodwill (particularly apparent in a personal services business) guides the segregation of the business components available for capitalisation as assets or financial resources under section 75(2)(b). The consequences being that alienable assets of the marriage can be capitalised and proportionally distributed based on point of time valuation, whereas, the financial resources of the marriage partners cannot be proportionally distributed at a point in time. They can be considered with respect to the on-going capacity to contribute to post-marital up-keep or maintenance.

Lack of appropriate methodological consideration can lead to double counting of both personal and enterprise goodwill as capitalisable intangibles for point of time distribution and again considering the same amount as personal goodwill, which, contributes to an individual's capacity to finance on-going marital obligations. Appropriate valuation methods, applied separately to asset valuation and financial capacity quantification, flow from the recognition of the methodological differentiation and the specific circumstances and attributes of the business at hand. For example, quantification methods include Future Maintainable Earnings, Discounted Cash flow, Industry Benchmark and Comparative Business Sales, may lose their validity if constraints, such as alienation, limit their methodological rationality. An accepted patterned principle may be to capitalise a revenue stream, but, if the revenue stream has limited transferability to a new owner, then it may not be a valid interpretation to be fully capitalised or included in the quantification measurement.

The importance of this academic contemplation of a hierarchical approach to valuation facilitates a more rigorous and informed assessment of a valuation expert's evidence, particularly in the valuation of professional practices for family law purposes. However, the strength of this understanding falls short of the validation that would be provided by a research-based theory or scientific predictability.

Cleansed of academic purity, the hierarchical consideration flows firstly the value to owner objective, followed by the methodology distinguishing asset valuation and financial capacity, then to the selection of the appropriate recognised calculation method. This is informative to:

1. The courts in their decisions pertaining to sections 79 and 75 of the Family Law Act;
2. Legal instructions to valuation experts pertaining to the quantification or valuation of personal and enterprise goodwill components;
3. The explanation of specific professional practice valuations by expert witnesses; and
4. The understanding of the parties to proceedings.

Family Law Act 1975 – section 75, section 79

Section 75 of the Australian Family Law Act 1975 prescribes the only matters to be taken into consideration in relation to spousal maintenance when exercising jurisdiction under section 74 of the Act. In particular section 75(2)(b) and (n) state:

> *(2) The matters to be so taken into account are:*

> *(b) the income, property and financial resources of each of the parties and the physical and mental capacity of each of them for appropriate gainful employment; and*
>
> *(n) the terms of any order made or proposed to be made under section 79 in relation to:*
>
> *(i) the property of the parties;*

"property" means: in relation to the parties to a marriage or either of them, means property to which those parties are, or that party is, as the case may be, entitled, whether in possession or reversion;

Section 79 of the Australian Family Law Act 1975 provides the latitude for the Court to alter property settlements such that the Court may make such orders based upon its decisions (just and equitable) regarding the settlement or transfer of the interests of the parties to the marriage in the property. Including:

> *(1) (c) an order for a settlement of property in substitution for any interest in the property; and ……*
>
> *(4) In considering what order (if any) should be made under this section in property settlement proceedings, the court shall take into account:*
>
> *(e) the matters referred to in subsection 75(2) so far as they are relevant;*

The Court can grant an adjournment in the property settlement proceedings (sec 5(a)); grant interim orders (sec 6); and generally take into account if there is likely to be significant change in the financial circumstances of the parties or change any of the property of the parties, if that change is more likely to do justice as between the parties to the marriage than an order that the court could make immediately.

In Pope v Pope (2012) Ryan J articulated the general principles for the adjustment of matrimonial property stating:

> The approach to the determination of an application under s 79 is well established by authority. In the Marriage of Lee Steere and Lee Steere (1985) FLC 92-626; In the Marriage of Ferraro (1993) FLC 92-335; In the Marriage of Clauson 1995) FLC 92-595. The process ordinarily involves a four part procedure. Firstly identifying the property, liabilities and financial resources of the parties at the time of the hearing. Secondly, evaluating the contributions made by the parties as defined in s 79(4)(a) to (c) and the effect of any proposed order upon the earning capacity of either party. I must then evaluate the matters contained in s 75(2) insofar as they are relevant, any other order made under the Act affecting a party or child and any child support ……..
>
> In determining what order the Court should make under s 79, the Court must be satisfied in all the circumstances that it is just and equitable to do so (s 79(2)). It is the justice and equity of the actual orders that the Court must consider. Russell v Russell (1999).

The section 75 and section 79 decision-making process is one for the judge, whose ultimate aim is to divide the property between parties. The valuation issues are a step in the process that may or may not be material to the ultimate decision. The expert valuation role is to assist the court, not to make the decision for the court.

The value to the owner concept in Family Law

Past colloquial expressions of valuation theory have, in fact, been unrestrained expressions of ontology through to methodology, largely transported from the courts as transcribed from Justices in their deliberations. It has been claimed that "considerable judicial commentary provides a framework for reviewing and critically analysing valuation theory." (Valuation Principals and Practise, 2008), however, this is to subscribe a role to the courts they neither play nor wish to acquire.

One of these manifestations is that the 'Spencer' doctrine is quoted incorrectly, as theory. Whipple (1995) has done much to expose the inappropriate use of this doctrine that adopts the definition of 'fair market value' and the concept of 'willing buyer willing seller'. The term valuation is understood in predominantly two ways, being the positivist 'market valuation' and the normative value to the owner. Both have inherited several titles such as exchange value, sale price or market value for the former and realistic value, just price, cost of reproduction, fair market value for the latter.

Whilst it is noted that the Full Family Court first questioned the then generally accepted the principle espoused in Spencer's Case (1907) of a "hypothetical willing but not too anxious purchaser and vendor" in the matter of Reynolds (1984), the concept of value to the owner was not new. Indeed Bonbright (1937) argues that:

> ….. 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.

Bonbright points out that "any object of wealth may be capable of conferring different advantages on different owners' and therefore should not be referred to as the value of property 'in general'". He notes that 'in many reported cases' the reference to the value of property to a specific group is differentiated as its 'real value' rather than its 'market price'.

Bonbright highlights two "distinct but related" concepts of value being "the one referring to sale price and the other referring to value to a specific owner". He counsels that:

> the value concepts of the courts betray a tendency to slide over unconsciously from the idea of value as a mere sale price to the idea of value as worth to the owner

Spencer's case was regarding compensation for land resumption by the Commonwealth, whereas, in the marriage of Reynolds the Full Court said:

> 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 capital value of shares in a proprietary company may not reflect their value to the spouse who either has control after the divorce or who stands ultimately to benefit from them or control them after the death of generous parents, as appears the case here.

APES 228, Valuation Services (2008), instructs members of the accounting profession to clearly define the valuation terms used, encouraging reference to "the International Glossary of Business Valuation Terms which are included in the valuation standards of the American Institute of Certified Public Accountants and the Canadian Institute of Chartered Business Valuators" (para 7.2)

This Glossary defines value to the owner as 'investment value' being "the value to a particular investor based on individual investment requirements and expectations". The alternative use of the term 'value to owner' in the Canadian context is noted. This is in contrast to the definition of a market based approach to valuation being "a general way of determining a value indication of a business, business ownership interest, security, or intangible asset by using one or more methods that compare the subject to similar businesses, business ownership interests, securities, or intangible assets that have been sold."

Vella (2009) provides a working definition of 'value to owner' as:

> 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

Vella's definition is espoused after consideration of the following case material and notably removes any reference to a 'hypothetical' or 'notional' buyer. It includes a "relevant facts" catch-all to allow for a range of factors such as market conditions, timing variances, minority holdings and future pertinent risks.

Most of the early judicial instruction regarding 'value to owner' comes from cases involving minority share holdings, however, the Family Court has been reticent to say what value to the owner means other than alignment with the term 'realistic'. Warnick J turned to the question of what earlier judgments meant by the word 'realistic' in Ramsay (1997), reflecting that, in a number of cases, the term had been seen simply as 'shorthand' for the expression 'value to shareholder'. The judge noted an area of tension in this usage, commenting that value to the shareholder (in Family Law) includes a "number of assumptions about the receipt of benefits (often not attaching to the shareholding 'per se')" over "the value that can be achieved on sale …. Thus it has a strong 'notional' aspect, in contrast to the reality of the market' as well as recognition of what can be achieved on sale."

Similarly, the courts have not been clear on handling 'special benefits', particularly where speculation with regard to future events may be required (Warnick J. in Ramsay). The Glossary defines a special interest purchaser as an "acquirer who believes they can enjoy post-acquisition economies of scale, synergies, or strategic advantages by combining the acquired business interest with their own”. In Family Law terms, this definition extends to special value associated with elements of worth (benefits) or of a going concern.

In Dunbar and Dunbar (1987) the Full Court seemed to generally advocate the willing buyer, willing seller objective stating: “The object of any valuation exercise is to establish what a willing but not anxious purchaser would be prepared to pay and a willing but not anxious seller would be prepared to accept”, in line with Spencer (1907). However, a line of decisions commencing with Hull and Hull (1983) the Family Court modified that approach. In Hull and Hull (1983) and in Bowman and Bowman (1984), Nygh J commented, “the Court must approach a question of valuation on a realistic basis …. The test laid down in Spencer’s case … can only be applied where there is a ready and available market.” Judgement was passed that the willing buyer, willing seller foundation was not appropriate because it was ‘artificial’ to say that the wife’s interest in the company was ‘valueless’ even though the shares currently did not provide dividend earnings. The judge attributed a value to the shares of asset backing without further explanation.

In Reynolds and Reynolds (1985) the Full Court confirmed his Honour’s questioning of “whether valuation methods which have been developed for commercial purposes are entirely appropriate for the purposes of family law”, recognising that the value of a minority shareholding had a value to the husband even though the present commercial value did not reflect its value to the husband. Similarly, in Sapir and Sapir (1989), Young J agreed that the value of shares should be discounted at a lower rate, reflecting their sub-ordinance to her parents shareholding, in order to establish the value of the shares to the wife rather than a higher discount factor should the shares have been marketed to a third party.

In Turnbull v Turnbull (1991) the Appeal Court agreed with the approach taken in Reynolds, Sapir and Hull noting:

> It is not appropriate in the context of Family Law proceedings to value shares in private family companies on the basis of what a hypothetical purchase may pay for them. Similarly, it is quite inappropriate to adopt the approach taken in the revenue and resumption cases.
>
> 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.

In Harrison and Harrison (1996) the Full Court stated:

> …. 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.

Does value to the owner mean realistic, and if so, what does "realistic" mean? In Ramsay v Ramsay (1997) Warnick J made some observations about the term 'realistic' after first recognising earlier cases including those above.

> 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 attached 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

Further his honour proffered 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;
>
> (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. [at 999]

In a later case, AJW v JMW (2002), Warnick J, before stating that the value to owner concept was not a methodology but an objective noted that:

> This value known as value to the owner considers and takes into account the additional economic benefits that ownership 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.
>
> …….. as noted that definition contains within it, the reason for its selection, namely, the existence of special benefits.

Whilst its gestation may have been in non-controlling interest cases, the value to the owner concept has been broadly applied under Family Law, particularly evident in professional practice cases. For example, the accounting profession in Hegarty v Hegarty (2002); the law in Best and Best (1992,) and in B and B (2000); and the medical profession in Scott and Scott (2006).

In Best and Best (1993), the husband was a solicitor in a large legal firm which was clearly a no goodwill firm (partnership not transferable or realisable on sale, death or retirement). The court was presented with two valuations based upon the balance of capital and current accounts. However the wife's valuation included a further amount being the capitalised value of future earnings calculated from a super profit calculation method.

The Court opined of the capitalised proportion above that "such an 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 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." Gee J went on to treat the husband's partnership interest as a financial resource under section 75(2).

On appeal the Full Court reviewed decisions in Everett (1980), Galland (1986) and Reynolds (1984), discussing the concept of property in the Family Law context. The valuer for the husband had stated that "treating the husband's interest as property was illusory, lacking a sense of reality because the interest was not really transferable, not saleable and not capable of being mortgaged as a security", nevertheless the Full Court referred to the husband's interest in the partnership as property. The husband was noted to have rights under the partnership agreement even if those rights were truncated and would present difficulties in valuation and in the application of orders under s 79.

Consequently we have tension between the value concept applied by Gee J in the original case where he described his valuation of "capitalised value of future earnings" applied as a financial resource of the husband and the counsel for the wife's valuation as "the value to Best of his interest as a partner" applied as property favoured on appeal. The Court was not called upon to instruct on consequent methodologies or the valuation flowing from this discussion.

Similarly in B and B (2000), where the husband was a partner in a large legal practice, the valuer for the wife followed the decision in Best, applying a valuation in excess of the capital account value using a discounted cash flow method applied to super profits and calling it "capitalised value of future earnings". The husband's expert put forward that any value in excess of the capital accounts constituted notional goodwill reflecting a financial resource of the husband.

Moss J distinguished Best on the basis that whilst transfer of partnership rights were limited they were not inalienable as they were in B and B. Consequently, his honour discussed the suggestion that "an interest must be capable of alienation or assumption by a third party in order that it be characterised as property". His Honour concluded:

> 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 [at 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 from the category of property." [at 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: "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." [at 91];

> 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." [at 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. 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 [at 93].

On appeal (though outside any valuation issues) the Court stated that they "should not be taken to endorse Moss J's conclusions' with respect to the positions where a partnership interest is to be classified as a non-assignable chose-in-action and therefore as a personal right in the Respondent, rather than a right of a proprietary nature, does not mean it has no value." The Full Court also appears to have shown reservations with regard to the concept that because such rights are not property, they cannot be the subject of an order under s 79.

Given the value to the owner objective and the case where the fair salary is less than the maintainable earnings before salary, it would appear that despite alienability restrictions there may be significant value to the owner albeit that it is not achievable in exchange.

In Hegarty and Hegarty (2002), dealing with the husband's 50% share in an accounting practice, it was restated that 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." The husband's practice relied upon a narrow stream of customers, being McDonalds franchisees, and hence it had minimal marketability, which was a focus of the court when assessing both prospective earnings and the capitalisation rate.

The judgement is somewhat opaque through mixed references as to the calculation's purpose of establishing market value or value to the owner, however, it is distinctive in its recognition regarding the adoption of the present value of the income stream to the husband on the assumption that he will not sell the interest. His honour did not canvas the possibility of a future sale of the practice nor the structured transfer of business constructed to reduce the risk of loss of clients in such a sale.

In Scott and Scott (2006) where a medical partnership was being valued in the presence of a partnership agreement stating an exit 'goodwill' price of $84,400 the Court was asked:

> 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 earnings was an inappropriate methodology.

The Full Court found that her Honour:

> was not bound to accept the valuation methodology expressed in the partnership agreement, as opposed to the capitalisation of maintainable earnings.

Her Honour had taken reference in Harrison (1996) which 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".

Value to the Owner, Personal and Enterprise Goodwill

The application of the value to the owner objective, based upon super profit methodology with particular relevance to professional practice valuations may be problematic where the business may rely upon significant personal goodwill rather than enterprise goodwill.

Delbridge-Bailey (2004) warns that:

> as the majority of professional practice valuation undertaken for Family Law purposes utilise the super profit approach (methodology) when combined with the value to owner objective (ontology) at risk is the potential double count of a professional's capacity to derive income, as both a capitalised value in the property pool and a future financial resource.

Goodwill is an intangible asset representing the premium an informed buyer is prepared to pay for the ownership of a business, over and above the value of its net assets or 'book value'. Goodwill has two components, being the enterprise goodwill and personal goodwill. Enterprise goodwill includes the tradable branding of a business, assignable supply contracts, established business system, established product range, location, supplier and associate affiliations, corporate memory and positive customer retention. A key feature of enterprise goodwill is that it is alienable, albeit that any transfer may be subject to conditions and limitations, which in turn, may require qualification with a discount factor.

In effect personal goodwill exists when the husband/wife or both parties' reputation, expertise or contacts gives the business its intrinsic value. Its prevalence is most likely in closely held businesses, professional practices, specialised businesses or businesses with few customers and suppliers. It is owned personally rather than by the business, and its characterisation is the subject of some dispute, in particular, the subset of professional goodwill.

By way of example, the relative balance between enterprise and professional goodwill exists on a continuum where the attributes of alienability vary from strong to weak. The stronger enterprise goodwill is found in businesses with a strong brand such as well-known franchises, proven and documented operating systems, larger and diverse management roles, replaceable individuals, prime locations, independent traffic flow, reliable suppliers and processes that support a profitable track record. There is most likely to be a ready market of purchasers that can invest for a relatively seamless take over the business. At the other end of the continuum high personal goodwill is more prevalent in smaller, unique businesses that depend on individual knowledge and relationships, may be limited in their marketability by agreement, dependent on a narrow and/or complex skill set for which there is little or no replacement.

Therefore, at the high enterprise goodwill end, a well-received and located franchise would be highly capitalisable with willing purchasers able to pay the seller for the business capital (both tangible and intangible) within a relatively short period. At the high personal goodwill end, the business, being dependent on the individual owner's relationships, management, skills and qualifications independent of structure would have low prospects to find a willing purchaser able to pay the seller for the business capital. Whilst there may be a super profit earned (above reasonable salaries) in either business, the high personal goodwill business is unable to realise that super profit as prospective profits brought forward under capitalisation. Instead, the super profits can only be realised (under the value to the owner objective) over time in the form of financial earnings.

For example, a highly qualified medical professional in a low capital intensive, plentifully supplied, regional specialist areas such as a rheumatologist, neurologist or gastroenterologist. The business may have a name and be established with clerical and administrative support. However, the referrals are personally addressed to the specialist with a limited life-cycle. The business depends on repeat and continuing referrals based on individual medical circumstances, the patients and their medical records are not transferable in their own right. Furthermore the skills and qualifications required to run the business are complex and rare, with any potential buyer possessing appropriate skills, having a choice in action to commence ‘from scratch’ a start-up alternative practice. The desire to operate the business in the existing location is also scarce. Whilst such a medical specialist can, no doubt, earn a significant premium through the business rather than available to a similar specialist employed, say, with a government department or hospital. A premium can be quantified through a super profits method, however, it is not alienable and hence not methodologically capitalisable.

The valuation would be limited to the replacement cost of the setup on the basis that a purchaser would prefer an existing business rather than having to set up the business in the first instance. The earnings premium cannot be brought forward to any significant extent without the alternative choice in action of commencing a start-up practice becoming a viable and attractive option. Under the value to the owner objective, however, the premium the specialist earns does have a value in that it is indicative of a future earning capacity.

As noted above section 75(2)(b) the “income, property and financial resources” of the parties are to be considered in the settlement process hence it is important to differentiate between the property and the financial resources of the parties particularly with respect to the characterisation of goodwill. Failure to do so may lead the court to double count the one income source as both property and a financial resource.

In the unreported matter of Wall and Wall (2002) concerning the husband and wife’s shares in a company carrying on the business of film producers and directors, the Court initially valued the business attributing goodwill using the super profits method and dividing by the shareholders 50:50 equity. The Full Court subsequently held that the trial judge had erred in not separately treating the personal goodwill of the parties as enterprise goodwill, explaining that the personal goodwill was an element of the husband's earning capacity which represented a significant section 75(2) factor.

The Full Court accepted Cohen J's recognition that the value should be ascertained "in the husband's hand" and that it was open to His Honour to reject the husband's submission that because the business relies wholly on the skills of the directors the goodwill is worth nothing; quoting Wayne Lonergan (1996):

> The reality is that goodwill exists because a business has a demonstrated capacity to earn cash flows exceeding the cash flow which one would normally expect if one were to invest the same level of tangible and identifiable intangible net assets in a similar business starting from scratch [at 71]

However the Full court rejected the earlier treatment in valuing the goodwill of the company pointing out "that there is a significant element of personal goodwill attaching to both the husband and Ms Lee in this case, which is clearly not transferable, and which, in the case of the husband at least, is really part of his earning capacity rather than property." Again, with reference to Lonergan, the Full Court outlined the varying attributes of enterprise and personal goodwill highlighting that the judge had accepted a grossly inflated value for the business by not differentiating between the two types of goodwill.

Delbridge-Bailey (2004) summarises that "while still having the objective of arriving at the 'value to the party', the Full Court has made a clear distinction between the value of enterprise goodwill and personal goodwill and earning capacity versus property." She counsels that "In applying a value to the owner objective it is, therefore, necessary to carefully consider the appropriate methodology and also the origins of any resulting goodwill. A clear distinction needs to be made between personal and enterprise goodwill together with an appropriate allocation of an income stream between property and financial resources". Delbridge-Bailey (2012) cites further cases involving consideration of personal goodwill. In Goddard and Patterson (2011), a case involving a firm of architects, the court found that the business was "dependent on the husband and that he is the creative focus of the practice and clients are gained through his skill and reputation" and therefore constituted personal goodwill. Finding that the goodwill of the business was all personal the Court treated the goodwill as "consistent with the approach of the Family Court in Wall and Wall (1999) any personal goodwill may constitute an additional financial resource (not property) of the husband." The Full Court subsequently upheld this view.

It is contended then that personal goodwill, or particularly professional goodwill, is inextricably attached to the individual, representing the present value of future earnings potential. However, distinguishing personal goodwill from enterprise goodwill is always fact specific and the relative prevalence of enterprise
goodwill in the legal context compared with personal goodwill carries the danger that all goodwill is treated as enterprise goodwill.

There are practical steps that run contrary to the argument that what is personal to one individual cannot be transferred to another. To revisit Warnick J, the expert can relieve the tension of the future earnings versus property debate by "identifying those factors, the import of which ought to be left to the discretion of the Court'". For example, contractual bargaining such as non-competition agreements that recognise that personal goodwill affecting future business has a value in being neutralised. Further, an individual possessing personal goodwill can effectively transfer it to a buyer through education, advertising, introduction or otherwise. If value to the owner is grounded in reality, then such transfer is a reality commonly recognised and regularly transferred between professionals. The valuation expert should, having assessed the relative potential of personal and enterprise goodwill on the facts and specified the method used, should inform the court of the means, relative propensity and likelihood of converting personal goodwill to enterprise goodwill. The Court can then factor that information into an assessment of section 75(2) decisions.

Revisiting s 79 where the court has the latitude to take into account if there is likely to be a significant change in the financial circumstances of the parties, or change any of the property of the parties, the opportunity and obligation exists for the valuation expert to comment upon the likelihood or propensity for the transfer of personal goodwill to enterprise goodwill in the future. This, of course, depends on the specific circumstances of the matter at hand, however, it is worthy of note that the valuation of the cases providing guidance on the value to the owner objective appear to do so "regardless of whether that value can be achieved by the party at the present time" (Delbridge-Bailey, 2004).

Conclusions and Further Research

The evolution of a philosophically sound valuation theory has not taken place. Instead, the Family Court has provided guidance with respect to the valuation objective, methodology and methods, in the form of a paradigm suitable for its jurisdiction. The Court has not attempted to define theory with its value to the owner objective, however, the Court's guidance needs to be interpreted hierarchically in order to appropriately and purposefully apply the valuation expert's methods and tools.

This is particularly relevant to its application to the valuation of goodwill and its two main variables, personal and enterprise goodwill. Often an issue in the valuation of professional practices, consideration of personal goodwill without consideration of alienability at the methodological level can lead to clouded, or no, differentiation between the capitalisation of enterprise goodwill and future financial capacity aided by personal goodwill. Basing decisions on the method of valuation without prior methodological consideration can affect the parties by leading to double counting of property and earning capacity, and cash flow limitations.

Potential exists for valuation experts to include in their reports information with regard to the separation of the types of goodwill, the attributes that define such separation and the potential for conversion of personal goodwill to capitalisable enterprise goodwill.

In order to aid the professional discipline of valuation, a research-based theory of business valuations would serve to enhance the credibility of practitioners, replacing the collection of generally accepted concepts drawn from field practice and subsequently adopted by academics. Such theory provides the basis for clearer, more consistent and credible evidence to be placed before the Court.

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