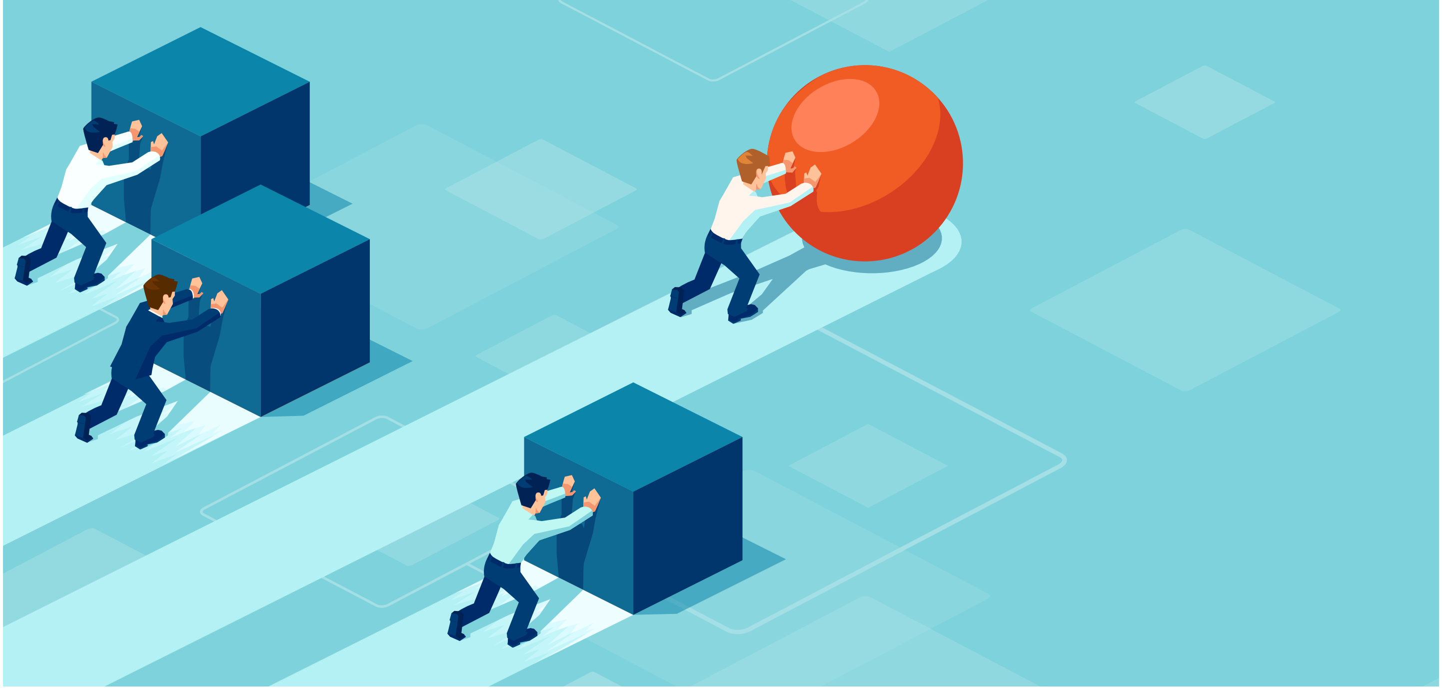
PITTING VALUATION THEORY AGAINST A FAIR OUTCOME?



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The recent judgment of Mostyn J in the matter of E v L [2021] EWFC 60 (Fam) again raises the question of the challenge and use of retrospective valuations in matrimonial disputes. The approach of Mostyn J over the years clearly demonstrates that he, and other Judges, are not afraid to adjust expert valuations in order to achieve a fair result for the parties.

In our experience, and put simply, retrospective valuations are required to understand the value of assets brought into the marriage and assess the extent to which the current value may be split between matrimonial and non-matrimonial assets.

The theory

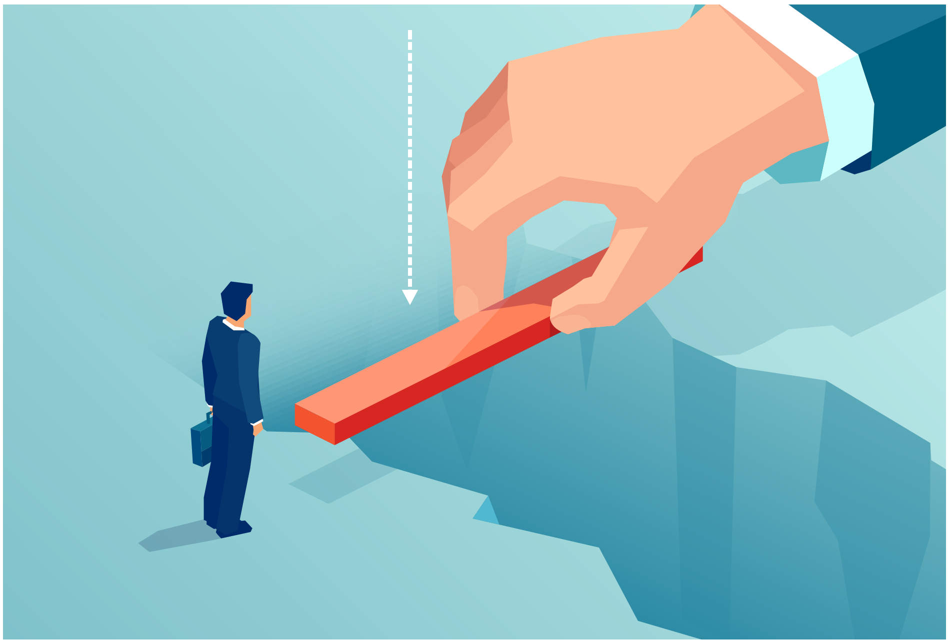
A retrospective valuation, in theory, seeks to determine the value of an asset at a date in the past. In doing so, a valuer needs to take themselves back in time to the date of the valuation – they should only consider the information that was available to a hypothetical purchaser at the date of valuation as this is what the purchase price would be based on. In doing so, it is necessary to ignore the benefit of hindsight.

In his judgment Mostyn J rather aptly refers to this approach as a "blindfolded valuation".

For example, if we were valuing a company in October 2019 the word COVID-19 (sorry) would be completely alien to us. While it may seem wrong now to apply a value to a company at October 2019 ignoring the impact of the pandemic, this expectation applies the benefit of hindsight. This is quite a black and white example as the impact of the pandemic was not something "in the making" in October 2019.

A business being sold in October 2019 would have been sold on the basis that it would continue generating profits as it had done in the past. Since March 2020 many UK businesses have in fact generated significantly lower profits as a result of the pandemic. At today's date an October 2019 purchaser may be very unhappy with the price paid for a business, and we have seen legal claims brought as a result of the diminution in value caused by COVID-19. The success (or otherwise) of those claims is irrelevant to this article but the point remains that any purchaser in October 2019 is highly unlikely to have contemplated COVID-19.

By contrast, the matter of Jones v Jones [2011] EWCA Civ 41 raises the question of the extent to which a



company may be pregnant with value at a historic date. During the marriage the company at the centre of this matter demonstrated significant growth but to what extent had the foundations been laid prior to the marriage?

The challenge

This latest judgment pits "pure valuation theory" against "a broad analysis of fairness" in acknowledgement of the fact that the answer to questions regarding value can result in "an award of hard cash".

What is fair?

In reaching his conclusion, Mostyn J exercises "discretion" and excludes the valuations which he considers have been "invalidated by hindsight". While it may seem strange to ignore expert opinion, ultimately, the judge has a full picture of the relative positions of the parties whereas the expert will not – the expert usually has no idea what other assets or resources a divorcing couple have, or their value.

As such, it can seem completely arbitrary when a judge concludes on valuation based on their own interpretation of the financials, such as in:

- **Martin v Martin [2018] EWCA Civ 2866 where Mostyn J assumed straight line growth over the lifetime of the business which he considered "resonates with fairness" (the approach was upheld on appeal by Moylan LJ). The date of marriage was towards the beginning on the life cycle of the business and Mostyn J's approach resulted in a higher value than that which had been determined by the expert; and**
- **Jones v Jones [2011] EWCA Civ 41 (appeal) where Wilson LJ accepts a "highly arbitrary" value of double that determined by the expert accountants to reflect a "spring-board" in place, not recognised in the experts' valuations; or even**
- **Hart v Hart [2017] EWCA Civ 1306 [2018] 2 WLR 509 (appeal) where a "wholly speculative guess" as to the husband's pre-marital wealth was accepted.**

Given that the whole exercise is shrouded in the hypothetical, and retrospective valuations are inherently more difficult than current valuations, it could be argued that a valuation using an approach not based on theory is no less fit for purpose/robust than a formal valuation exercise.

Rather than leaving it to judges to draw valuation conclusions, should experts be instructed to conclude on a value that is fair?

That could be a risky approach – what is "fair"? And to whom?

As already mentioned, when instructed we may only have a small piece of the puzzle. Add to this the fact that (according to numerous judges) business valuations are already "fragile". If an expert starts tweaking a valuation for what may be fair, they risk stepping away from their expertise and producing a valuation that is even more "fragile" and of limited utility.

The answer…

Is probably for experts to keep doing what they are doing and provide the Judge with the starting point and the tools which can be employed to conclude on a fair result in the context of the divorce as a whole.

That said, the may be circumstances where it is appropriate for instructing solicitors to provide the expert with some assumptions to adopt. For example, if the date of marriage was at the height of the 2008 financial crisis and the company subsequently recovered, solicitors could instruct their expert to ignore the impact of the crash. Whether or not a) such instructions can ever be agreed and b) they can be used in practice by an expert remains to be seen.

Ultimately there is no "one size fits all" approach, as demonstrated by the different approaches adopted in different judgments.