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THE VALUATION LAW REVIEW

Family Law Decisions

The Valuation Law Review is a joint publication of The Canadian Institute of Chartered Business Valuators and Harrison Pensa LLP and this issue summarizes family law decisions of interest to business valuators. The Valuation Law Review is not intended to provide legal advice and readers should not act on information in the publication without seeking particular advice on matters that are of concern to them. Readers are cautioned against relying upon the decision abstracts contained herein, which are edited and in outline form only, and are directed to the full report of the reasons of the Court.

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Johnston v. Johnston (2006), 18 R.F.L. (6th) 357 (Alta Q.B.).

The husband was an anaesthetist. He carried on his practice through a personal corporation, which under *Alberta's Matrimonial Property Act*, would be "matrimonial property". Under that statute, matrimonial property is normally valued and divided as of the date of trial.

After the parties separated, the husband withdrew $444,500 as a dividend from the corporation. $75,000 was provided to the wife, $107,000 was paid in income taxes and a significant portion of the balance was used by the husband to acquire a home known as the "Crestwood" property. The wife following the separation took out a mortgage on the parties' vacation home in Invermere, B.C. and undertook substantial renovations to it.

Amongst the issues the court had to decide were:

1. The value of the professional corporation (having regard to the extraordinary post-separation dividend);
2. Whether the wife was entitled to a share in the value of the "Crestwood" property having regard to the fact that it was acquired by way of the post-separation dividend; and
3. Whether the mortgage of the Invermere property was a matrimonial liability.

Both parties called experts to testify as to the value of the personal corporation. Both experts agreed that:

1. There was no commercial goodwill in the corporation; and
2. The Alberta legislation required that the $444,500 dividend had to be "added back" to the corporation's value.

Although the trial took place in 2005, both experts valued the corporation as of 2004, as those financial statements were available.

The wife's expert employed three approaches to value. The first was a simple "asset-based approach". The $444,500 was added back to the value of the corporation and the assumption was that the assets would be distributed by way of dividends over a reasonable time frame (5 to 10 years). The 24% tax on dividends was discounted to 20% to reflect its

deferral. This resulted in a net adjusted book value of $671,000. He disregarded all payments to the wife.

The other two approaches assumed that the husband should have drawn a "normalized" salary after the separation (either by reference to his historical salary average or the average salary of Alberta anaesthetists) while the balance would be added back to the value of the corporation and distributed by way of dividends over time. These resulted in adjusted net book values of around $537,500 and $733,000 respectively.

The husband's expert applied a simple liquidation approach. He added back the $444,500 dividend, ascertained the net book value of the company, further reduced the value by payments to the wife, and deducted 24% for income taxes. He arrived at a value of $540,000. He disagreed that the tax rate should be reduced to take into account its deferral.

The court held that an asset-based approach was appropriate. It rejected the two alternative approaches suggested by the wife's expert as being hypothetical. The court added back the dividend to the company's retained earnings to arrive at its book value. The court applied a 20% tax rate, noting that the corporation would not be liquidated in one fell swoop. The court held that the $107,000 income tax liability on the dividend was the husband's sole responsibility. The court, however, credited the husband with $93,000, being the $75,000 paid to the wife, grossed up by 24%, as the tax consequence was immediate.

The court held that the "Crestwood" property was not marital property due to the "add-back" of the dividend.

Finally, the court held that the mortgage on the Invermere property was not a matrimonial debt. It had always been intended that the wife would receive this property as part of the property distribution. Thus, the debt was incurred on her sole account.

As an aside, the corporation had grown in value (from 2004, when the experts valued it) to trial by $253,328. The Alberta statute allows the court to make an unequal distribution of an asset if equality is "not just and equitable". The court divided this increase on a 60/40 basis. It noted that

the increase in value, while the product of increases in the husband's earning power and seniority, called for equality, the increase occurred after the separation and was also the product of the husband's hard work.

Poirier v. Poirier (2006), 19 R.F.L. (6th) 197 (Ont. S.C.J.)

The testimony of the husband's accountant, in respect of the value of his business, was given little weight. There was a clear lack of objectivity and a conflict of interest.

The husband was the sole shareholder of R. Ltd., a holding company which owned 60% of the shares of C. Ltd., an operating company that sold tractors and construction equipment. At issue was the value, therefore, of the operating company. Under Ontario's *Family Law Act*, each spouse's net worth on the date of separation is calculated. Subject to certain exclusions and a deduction for the spouse's net worth at marriage, the spouse with the greater net worth must ordinarily pay an equalization payment equal to one-half the difference in their net worths. Ontario's legislation, therefore, differs from that of most other provinces where matrimonial property is "distributed" or "reapportioned" at trial.

The wife engaged an expert who valued C. Ltd. at around 2.1 million dollars, yielding a value to R. Ltd. of $1.4 million. In so doing, the wife's expert employed a rate of return of 17%.

The husband, upon receiving the wife's report, was most upset. As a consequence, he sent the report to the company's long-standing external accountants with a clear mandate to come up with a lower valuation.

The husband's accountants prepared a draft report valuing the shares at about $1.1 million, employing a rate of return of 20%. Still dissatisfied, the husband instructed them to do better. They then came up with a second report valuing the shares at around $670,000, employing a rate of return of 25%.

The husband's accountants justified their higher rate of return noting that the husband brought significant personal goodwill to the company. Factually, this was rejected by the judge who noted that the accountant relied heavily on the husband's account of his personal goodwill, that the dealership was well-established, that it sold a very good product line, and that a significant proportion of the sales were affected by an employee.

In rejecting the testimony of the husband's accountant, the judge had this

to say:

I have very little faith in the conclusions reached by [the husband's accountant] concerning the value of C. Ltd. I find that [the husband's accountant] is in a very difficult conflict of interest position. The husband is a good client of the accounting firm. The husband specifically hired his [accountant] to come up with a lower valuation. He reviewed the wife's report before starting his own valuation...When one considers that a 5% increase resulted from the discussion of the draft with the husband, who admittedly was not satisfied with the draft, the valuation opinion loses all of its objective value. I reject [the husband's accountant's] valuation as unreliable and clearly biased.

A second issue arose as to the impact of "cash sales" or unreported income on valuation. The trial judge concluded that..."the evidence does not establish that they would have had any role in the negotiations between a notional purchaser and vendor". The editor suggests that this represented the trial judge's view of the evidence in this particular case. Unreported income or improper deductions from income would normally be adjusted to reflect normalized earnings. See, for example, *Debora v. Debora* (2005), 8 R.F.L. (6th) 32 (Ont. S.C.J.).

Greither v. Greither (2006), 22 R.F.L. (6th) 10 (B.C.C.A.)

A trial will not be re-opened to admit valuation evidence that differs from that proffered by the party at trial.

The parties had concluded their family law trial, both parties had rested their cases, and the judge had reserved his judgment. The wife asked the judge to delay his judgment pending further disclosure. At issue was the value of shares owned by the parties.

In due course, the wife asked the judge to re-open the case, to enable her to lead additional valuation evidence which was different from the methodology of the valuator called by the wife at trial.

The trial judge refused to allow the re-opening and proceeded to give judgment. The wife appealed.

The Court of Appeal dismissed the appeal. Under the B.C. *Family Relations Act*, assets are re-apportioned as of trial. Re-opening the trial would require a revised valuation date. Moreover, the wife's new valuation theory

contradicted the theory put forth by the valuator she had called at trial. It would be unfair to allow her to change theories after closing her case.

Fox v. Fox (2006), 26 R.F.L. (6th) 64 (Ont. S.C.J.)

Where assets must be valued at date of marriage and date of separation, the valuation methodology should be consistent for both dates unless the evidence justifies a different approach.

The husband was a lawyer. By his late father's will, he was entitled to 25% of the income of the estate, his mother was entitled to 75% of the income and the estate remaining would pass to him upon his mother's death. As the inheritance occurred prior to the marriage, it was necessary to value the husband's interest on the marriage date and the date of separation under Ontario's *Family Law Act*.

The husband's mother, who was the estate trustee, was a religious bigot. When she discovered that the husband was going to marry a woman outside of their faith, she sold off estate assets. She effectively stripped the estate and conveyed certain real estate assets to the children of the husband's first marriage, pursuant to a power contained in the will which allowed her to encroach on capital.

Years of litigation followed. The husband lost at trial, but the Court of Appeal reversed the trial judge, holding that the mother had not validly encroached on capital. Rather, she had done so out of bigotry. She was ordered to disgorge the proceeds of sale back to the estate and the children were ordered to reconvey the property to the estate. The estate and mother were ordered to reimburse the husband for a portion of his legal costs.

To complicate matters, the value of the estate assets had risen significantly after the parties' separation. Thus, the wife claimed to be entitled to a share in the estate on the basis of constructive trust.

At trial, a single real estate appraiser testified as to the value of the real estate at marriage and separation. Based on this evidence, both parties called actuaries to value the income and capital interests of the husband.

The real estate appraiser testified as to the property values in 1989 (the date of marriage) and 1999 (the date of separation). He provided an "income" approach and a "direct sales" approach to the separation date values. He applied only a "direct sales" approach to the marriage date

values as he lacked rental information. He was unequivocal that the "income approach" is the preferred approach in valuing income properties. He was not cross-examined.

In the closing address, counsel for the wife urged the judge to use the "direct sales" approach for both dates to ensure consistency. The judge disagreed. She noted that the expert was not cross-examined, the expert rejected such an approach where income information is available, and both actuaries had relied on the opinion of the real estate appraiser. She ruled that it would be improper for her to substitute a value contrary to that expressed by the only expert.

The actuaries used similar approaches in valuing the remainder interest of the husband in the capital. Both applied an indexed approach to the real estate at the date of separation. The husband's actuary did not do so for the date of marriage. He testified that in 1989, it was common knowledge that a real estate bubble had burst and that prices would decline. The court rejected this bifurcated approach. The court concluded that this was hindsight evidence in that the asset would fall into the estate only on the mother's death. The course of real estate prices until that date would be speculative. In this instance, in the absence of a compelling reason to depart from approaches, a similar approach should be applied in the valuations at marriage and separation dates.

The actuaries disagreed on the tax consequences. It was unclear whether the estate or the husband would be responsible for the tax on disposition of the estate assets. It was unclear whether the husband could add the costs of the litigation to the adjusted cost base of the properties. The husband's actuary had simply employed the highest marginal rate, and it was uncertain if that rate was appropriate. The court disallowed any tax discount, holding that it was not properly proven.

The wife argued that the marriage date values should be discounted for contingencies as, by that date, his mother had already taken steps to disinherit the husband. She argued that the discount should reflect the legal costs expended in the recovery and the risk of loss of the litigation. The court disagreed, noting that the asset was actually recovered, thus, its full value should be taken into account. Moreover, to discount the value due to the mother's unlawful act would allow the wife to take advantage of the unlawfulness denied the mother, by the Court of Appeal.

The wife was awarded a 20% interest in the estate on the basis of constructive trust. During the period that the husband litigated with his mother (and former wife over support), she provided substantial emotional support. She assisted in reviewing documents and providing administrative support to keep costs down. She was not paid a wage while she worked in the husband's law office. She sold her diamond ring to provide economic support.

Raaymakers v. Green (2006), 25 R.F.L. (6th) 54 (Ont. C.A.)

The court will not re-open a settlement simply because better valuation evidence has become available.

The parties chose to mediate their dispute which involved valuing their company. Its year end was February 28th.

They had been advised to obtain a business valuation, but chose not to do so. Mediation occurred in January and February of 1999, so the latest information available to them was the 1998 statements.

Using a formula based on retained earnings, they valued the company at $550,000. They signed a separation agreement to that effect. Had they waited for the 1999 statements, the formula would have yielded a value of $700,000.

The wife sought to set aside the agreement, alleging mutual mistake. Unsuccessful at trial, she appealed.

She was unsuccessful on appeal. The appeal court held that she and her husband had specifically chosen the methodology of valuation and had signed a domestic contract to that effect. She could not resile from the agreement simply because she now had better evidence of value.

Jakilazek v. Mitchell (2006), 150 A.C.W.S. (3d) 429 (Man. Q.B.)

In proceedings to vary child support, a spouse must disclose the value of his or her assets. Where a spouse is a shareholder in a closely held corporation, the spouse may be required to furnish copies of corporate financial statements and particulars of salaries and benefits paid to persons not at arm's length.

The parties were divorced in 2000. They entered into a consent judgment that provided for the division of their property, child support and spousal support.

In 2005, Mr. Jakilazek moved to eliminate his spousal support obligation. Section 17(4.1) of the *Divorce Act* permits the court to vary a spousal support order if the "condition, means, needs or other circumstances" of either party have materially changed since the last order.

Under the court rules, his motion required delivery of a sworn financial disclosure statement identifying all income sources, amounts of income, all assets, the value of the assets, and all liabilities. He identified a minority interest in a corporation (in 2000 he had a minority interest in two corporations), but did not identify the value of the interest. His tax returns indicated that his second wife earned more than him (as an employee of the corporation in which he had an interest).

The court dealt with a "shopping list" of disclosure items requested by his former wife.

The court required him to complete the "value" disclosure of his financial disclosure form by estimating the value of his minority interest. He was required to provide his "*bona fide* estimate". An estimate is bona fide if there is a reasonable basis to defend it. The value of assets are part of a former spouse's "means".

The husband objected, generally, to the production of corporate financial statements, noting that he had a mere minority interest. The court noted that he was the moving party and, consequently, bore the onus of proof. A failure to produce such documents could impact on his credibility as they could support or contradict his allegations. Moreover, court rules carry a deemed undertaking as to confidentiality. As his income is derived from the corporation, the statements could confirm or contradict his alleged reduction in his income.

The husband objected to the production of income information of his second wife. However, the court noted that her income would be part of his "means" even though she would not owe any obligation to provide support.

The court ordered that he list all of his corporate holdings over the past 5 years, the percentage ownership, the approximate value of the holdings, and his position or positions within the corporation.

The court ordered that he provide a copy of any net worth statement provided to any financial institution or third party. If he did not retain copies, he was to obtain them from the bank, lending institution or third party.

The court ordered production of all documentation in relation to the company that had ceased operations such as Articles of Dissolution or sale documents.

The court ordered him to produce full financial particulars of the income, salaries, benefits, bonuses, or other funds paid to his second wife. This would include T-4's and other evidences of payment.

Noting that the corporation was not a party to the motion, the court declined to order production of the corporate forecasts and projections, corporate loan applications, corporate tax returns or copies of the shareholders' register.

Cook v. McManus (2006), 150 A.C.W.S. (3d) 179

Where a spouse owns or controls a corporation, the onus will be on him or her to justify why the corporate income should not be attributed under s. 18 of the Child Support Guidelines.

The parties had entered into a consent order for child support based on the husband's annual income of $51,000. He was self-employed, carrying on business through a corporation. The husband brought a motion to decrease child support alleging that his business had suffered setbacks and he had to take a salary decrease to $23,400 annually.

The company balance sheet indicated substantial retained earnings. Under the *Child Support Guidelines*, a court can "pierce" the corporate veil and attribute the prior year's corporate income to a shareholder or it can impute income if capital is not appropriately utilized to generate income.

The court lamented that there was no expert evidence, fact specific to the corporation, as to the appropriate amount of retained earnings necessary for legitimate business purposes. The court held that there was no sufficient evidence of any need to retain earnings for capital replacement. Likewise, there was no evidence that the removal of some of the retained earnings would harm the company or that the company could not borrow funds to permit the removal of the retained earnings.

As a consequence, the court concluded that the husband had failed to prove that his circumstances had changed. The motion was dismissed.

Boisvert v. Boisvert (2006), 149 A.C.W.S. (3d) 988

A wrongful dismissal claim is "property" within the meaning of Ontario's Family Law Act. Production of documents may be obtained from third parties if germane to valuation issues.

The husband, for about a year and a half prior to the parties' separation, worked for A Corp. - a fledgling high tech company. He had no written contract. He was hired on the understanding that no one would draw a salary until the corporation turned a profit. It had been discussed that he would ultimately receive equity in the company ranging from 10% to 20%.

As a result of a disagreement with the founders of A Corp., he was fired. He commenced action against A-Corp. for damages for oppression, breach of contract, and breach of fiduciary duty or, alternatively, compensation based on *quantum meruit*. However, he said that he had no intention of actually pursing the litigation and started the court action merely to preserve the limitation period. He said that he could not afford the cost of the litigation. Thus, while he conceded that his claims constituted "property" within the meaning of Ontario's *Family Law Act*, he said that they were valueless due to his decision not to pursue the possible remedies.

The wife brought a motion to compel production of documents from A Corp. and its founders. While A. Corp. agreed to produce its historical financial statements and details of pending patents, it declined to produce company forecasts or projections, valuations, or a copy of the strategic plan.

The court ordered production of all of the documents, but on terms. The documents were to be released only to counsel, who could show them only to the client and any expert retained. The court file was to be sealed.

The court set aside a marriage contract by reason of the husband's non-disclosure and by reason of the wife's lack of understanding of the nature and consequences of the contract. Inadvertently, the husband and his solicitor misrepresented the nature and extent of his interests in various holding companies and a family trust. They failed to identify all of the holding companies. They failed to ascribe proper values to the assets in question. As a consequence, it became impossible for the solicitor acting for the wife to properly advise her as to the nature and consequences of signing the agreement. Moreover, the husband's continued misrepresentation, directly to the wife, of the effect of the agreement, undermined the solicitor's attempts to explain the agreement to the wife.

Under normal circumstances, it is inappropriate to rely on the trading price of shares of a publicly-traded company to determine the value of the corporation. Such a value must be determined independently on an en bloc basis. However, where the parties, themselves, have created a valuation formula in a unanimous shareholders agreement, the court is entitled to value the shares in accordance with such agreement.

LeVan v. LeVan. August 24, 2006. Backhouse J. (Ont. S.C.J.)

This case dealt with two important issues under Ontario's Family Law Act. The first dealt with the validity of a marriage contract entered into shortly before the parties married each other and the second dealt with the valuation of the husband's shareholding in a publicly-traded corporation.

The husband's father had founded a corporation known as W. Inc., a large auto parts supplier. With the assistance of his legal and financial advisers, he and his wife created a complex corporate structure which included several different corporations and a family trust. The purpose was to ensure that the shares in W. Inc. would not go to persons outside of the family.

The family members, consisting of the husband, his siblings, and his parents entered into a Voting Trust Agreement and a Unanimous Shareholder Agreement. Attached as a Schedule to each Agreement was a draft marriage contract which each child was expected to enter into if that child wished to continue to be a shareholder. The draft contract stipulated the method of valuation of the shares and limited the remedies of a spouse in respect of the companies.

In making his initial disclosure, the husband's solicitor merely represented that his net worth was approximately $80,000 plus his interest in "the family companies". The value of the family companies was undisclosed but the court concluded that it was, at the time, approximately $14 million. In describing the holdings, the disclosure was incomplete as the husband's solicitor failed to identify several of the holding companies in which the husband had an interest. She referred to certain shares as being "frozen", which was erroneous. She failed to disclose that her client, the husband, was an income beneficiary of the trust, stating only that he was a "contingent residual beneficiary".

In exchanges of correspondence, the husband's solicitor inadvertently misrepresented that the husband's interest in the family trust had "minimal value" (while the testimony of the wife's valuator at trial was that its worth was $3.4 million). The husband's solicitor erroneously stated that most of the husband's shareholdings were not vested. In fact, they were largely vested and had an approximate value of $10 million.

As desultory negotiations dragged on between the solicitor for the husband and the solicitor for the wife, the husband informed the wife that if she did not sign the contract, he would not participate in the marriage ceremony. The husband represented to the wife that the contract merely protected his shares from outsiders (when, in fact, it totally excluded the shares from his net family property). The husband criticized the wife's solicitor both personally and professionally. Bowing to the husband's pressure, the wife discharged her solicitor and engaged a lawyer chosen by the husband's solicitor who, by all description, merely "rubber stamped" the contract.

Finally, the contract contained provisions which severely restricted the wife's right to support in the event of marriage breakdown.

Under Ontario's Family Law Act, the court can set aside any provision of a domestic contract or the entirety of the contract if a party fails to disclose "significant assets, debts, or liabilities" or if a party did not understand the nature or consequences of the contract. The Act also provides that the parties may not contract out of disclosure.

Under the circumstances, the court set aside the entire contract. Due to the misrepresentations and failure to make adequate disclosure, neither the wife nor her solicitor could fully appreciate her potential rights under the Family Law Act and what she was giving up when she signed the agreement. Moreover, the husband misrepresented the effect of the contract. He had repeatedly told the wife that the contract merely precluded her from becoming a shareholder. In fact, the contract denied the wife any right to share in the increase in value of the shares during marital cohabitation. The husband's undermining of the original solicitor retained by the wife precluded him from offering advice that could be considered as being "independent".

Although the Family Law Act refers to "assets, debts and liabilities", the absence of any income disclosure militated against the court, supporting the validity of the restriction on the wife's right to claim spousal support.

Two business valuators were called at the trial of the action. The wife's valuator valued the shares in accordance with the very terms of the marriage contract, itself, and in accordance with the Unanimous Shareholders Agreement. She concluded that the husband's business

interests had a value of $33 million on the date of separation and $14 million at the date of marriage. Thus, the growth in value of the shares, of approximately $19 million, would be shareable between the husband and the wife.

The husband's valuator did not express any opinion of value. He was instructed not to do so by reason of the marriage contract. Instead, his engagement was limited to criticizing the methodology and the ultimate opinion expressed by the wife's valuator. It was his testimony that the only appropriate valuation method would be to value the shares in W. Inc. en bloc. He testified that it was inappropriate to rely on the trading price of the shares because there could be significant differences between the en bloc values of the businesses and the value implied by the trading price. It was his opinion that full valuations of W. Inc. would be required before any conclusions relating to the value of the husband's business interests could be made.

The wife's valuator responded that she had valued the shares in accordance with the methodology adopted by the shareholders in their Unanimous Shareholders Agreement.

The court accepted her approach and, noting that it constituted the only evidence of value before the court, the court adopted her opinion of value.

Ewing v. Ewing (2006), 150 A.C.W.S. (3d) 181 (Alta. Q.B.)

The court attributed corporate income to the husband for a lengthy period of time and, based on such attributed income, pronounced a very sizable retroactive child support award.

The wife sought retroactive child support from the husband, dating back to 2002. In February of 2002, they had agreed that the husband would pay $1,500 monthly child support. In 2004, they entered into a consent court order whereby the court ordered the husband to pay $6,000 monthly based on an income of $750,000.

In seeking retroactive support, the wife asked the court to go behind the 2004 consent order and also to attribute the corporation's profits to the husband, under s. 18 of the Child Support Guidelines. She engaged the services of an accountant who analysed the husband's personal income and the income of two corporations that he controlled. The accountant testified that the corporations' retained earnings in the period 2002 to 2005 were not required for corporate purposes. The accountant also noted in 2002 and 2004, the company paid out more than the pre-tax profits for those years, demonstrating that the income was available for distribution.

On her analysis, the accountant testified that the husband had an available income of at least $1.1 million for each of the years 2002 through 2005 inclusive, if the corporate income was attributed to him.

The court held that neither the agreement nor consent order afforded defences to the husband. He had underpaid his child support for 4 years. The court ordered him to pay $365,000 in retroactive support and ongoing child support of $13,766 monthly.

Shields v. Shields (2006), 150 A.C.W.S. (3d) 182 (Alta. Q.B.)

In 2004, the husband sold his business. The sale resulted in an actual capital gain of $118,229. If the gain was to be included in his 2004 income, his "adjusted income" for 2004 for Child Support Guideline purposes would be $282,828. If the capital gain was ignored, his income would be $164,597 for Guideline purposes.

The concept of "double dipping" does not apply to child support. The mere fact that a capital gain is non-recurring does not lead to its automatic exclusion from income for Child Support Guideline purposes.

The husband argued that the capital gain should be ignored for several reasons:

the value of the shares had been accounted for in the matrimonial property settlement. To now include the gain in income creates a "double dip"; or

1. the gain was a non-recurring income event and should be ignored for income purposes.

The court rejected the "double dip" argument. "Double dipping", the court held, related only to spousal support. In respect of spousal support, it would be unfair to award a spouse one-half of the capital assets and, when the capital is paid out as income (such as pension payments or RRSP's), to base the payor's support obligation upon the receipt of the remaining capital. The Guidelines require that child support be calculated according to parental income unless there is a special provision in an agreement, benefiting the child, that would make the Guideline amount inequitable. The parental property contained no "special provisions" that benefited the child.

The court also rejected the non-recurring income argument. The husband's income was known and identified. The fact that it might create a one year increase in child support was not unfair, as the husband had not re-invested the gain in another business.