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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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An expert must be neutral, objective and independent. The expert's testimony will be discounted if it appears that he or she is an advocate for a party or fixed in his or her views.
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Dababneh v. Dababneh
(2003), R.F.L. (5th) 55 (Ont. S.C.J.)

In this case, Justice Grant Campbell had to consider the issue of hindsight evidence. There has been a growing tenancy, in family law cases, to ignore the hindsight evidence rule. See, for example, *Iankilevitch v. Iankilevitch* (2004), 131 A.C.W.S. (3d) 700 (Ont. S.C.J.).

In *Dababneh*, the husband had guaranteed his son's loan. On the valuation date, the son had lost his employment although the loan had not yet fallen into arrears. The principal balance stood at $14,061.00. Following the valuation date, the son went bankrupt and the bank sued the husband for the entirety of the debt. He ultimately paid $17,400 to settle the case. Thus, the court was faced with two questions. First, was the husband entitled to a deduction because of his having to pay the son's debt and, second, what was the value of that deduction?

The court held that the guarantee constituted a contingent liability of the husband. Applying the earlier case of *Drysdale v. Drysdale* (1994), 9 R.F.L. (4th) 20 (Ont. U.F. Ct.), the court held that if there is a "real risk" on the valuation date that a guarantor will be called upon to make good the loan, a deduction may be claimed by the guarantor in computing his or her net family property.

Justice Campbell held that he could rely upon the hindsight evidence to establish the contingency being met. He could not, however, rely upon the hindsight evidence to establish the value of the contingency. Thus, he considered himself obliged to disregard the amount that the husband actually paid. Rather, the liability was quantified at the loan's value on the valuation date.

Reid v. Reid
(2003), 127 A.C.W.S. (3d) 941 (Ont. S.C.J.)

The issue of hindsight evidence can be avoided, entirely, in respect of contingent assets if they are divided on an "if and when" basis.

In 1997, the wife signed an employment contract with a large American hi-technology company. As part of her employment contract, she was granted stock options which were divided into five tranches or bundles. Each tranche would vest, annually, over the next five years.

The parties married in 1998. They separated in 2000, the marriage having lasted only 18 months and the total period of pre-marital and marital cohabitation having lasted 34 months.

On the date of marriage, none of the options had vested. As a result of the high technology boom, the shares rose, dramatically, in value. During the marriage, the wife exercised some of her options resulting in profits of almost $140,000 U.S. In so doing, the wife exercised all of the vested options to which she was entitled under the first tranch.

When the parties separated, in mid 2000, the wife had over 1,500 vested stock options at an exercise price of $8.00 while the market price of the security was $110.00. She had 10,000 further unvested stock options.

As a result of a corporate downsizing in early 2001, the wife lost her employment. Between the date of separation and the date of termination of her employment, however, approximately 2,500 further stock options vested. She was forced to exercise her vested options immediately upon the termination of employment which resulted in a profit, to her, of $207,000. She lost her rights to the third, fourth, and fifth tranches attendant upon the loss of her employment.

The court held that the unvested stock options constituted "property" within the meaning of the *Family Law Act*. The stock option created a legal right, though not an obligation, for the wife to buy stock at a fixed price. Thus, even though not vested, the Respondent had a right to acquire something in the future provided the conditions were met.

The court heard expert evidence with respect to the two traditional methods of valuating stock options.

The first expert employed the Black-Scholes model. It was a mathematical model which took into account the fixed option price, the expiry date of the option, the volatility of the underlying stock, the market value of the underlying stock on the date in question, the risk-free rate of interest, and any dividend rate on the underlying stock. The Reasons for Judgment did not disclose the values produced by this method. However, the court rejected the Black-Scholes model for two reasons. First, the model was applicable to publicly traded options. Second, it has no application to unvested options.

The other valuator employed an "intrinsic value" technique. Under that method, the option would be valued by calculating the gain or loss that would be realized if the option were exercised on the date in question. An adjustment would be made to take into account the "time value" of the duration of the option. Once again, the Reasons for Judgment did not disclose the results of this calculation.

The court did not apply either technique. Rather, the court employed the "if and when" method. Conceding that it was not a valuation technique but, rather, a means of dividing assets, the court felt that this avoided the problem of adducing evidence with respect to the present value of unmatured stock options. On the evidence before her, the Judge concluded that the Respondent actually received $207,000 from her vested and unvested stock options. This, the court concluded, was the appropriate value to be assigned to her options on the valuation date.

The court concluded that the stock options, being entirely unmatured and unvested on the marriage date, had a value of "nil".

Pakka v. Nygard
(2002), 61 O.R. (3d) 328 (Ont. S.C.J.)

In assessing child support, the court should not deviate from the amount prescribed by the tables except where the evidence is "clear and compelling". The amount of child support is not inappropriate merely because it exceeds the child's budgetary needs.

Interim disbursements may be awarded for the purposes of determining a spouse's income. The interim disbursement award was $35,000.00.

This case has attracted considerable attention in the media. The Defendant, Peter Nygard, was described in the judgment as being the chairman of Nygard International, the pre-eminent women's ready-to-wear clothing business in Canada, with sales approaching $300 million.

The court found that Mr. Nygard's residence was in the Bahamas. His income was found to be $1.7 million.

In determining his income for child support purposes, however, the court "grossed up" his income to $2.2 million. In so doing, the court expressly followed the calculations of a chartered accountant who noted that Mr. Nygard's income would not be subject to income taxation in the Bahamas (although a portion of his income was subject to Canadian tax). The court went on to order Mr. Nygard to pay $15,091.51 interim child support for their only child. The court did so even though the budget prepared by the child's mother indicated that the son required only $7,000.00 monthly. In so doing, the court noted that "needs" were not the sole determinant of child support. A child is entitled to have the same station in life as his or her parents. The court should only depart from awarding the amount prescribed by the child support tables in cases where the evidence is "clear and compelling" that a table-based award would be inappropriate.

The case is also unique in its award of interim disbursements. Nygard and Pakka did not live together although they had a relationship. Hence, there was no issue relating to the valuation of Mr. Nygard's assets. Rather, the issue before the court was Mr. Nygard's income for support purposes. His own accountant had deposed,

in an affidavit, that she "expended enormous effort and time" on the preparation of Mr. Nygard's Financial Statement. She rendered an account of approximately $25,000.00 for her own services. As a consequence, Mr. Nygard argued that Ms. Pakka required very little, by way of interim disbursements, to "review" the work of his own accountant. Moreover, he indicated that he had instructed his accountant to co-operate, fully, with the wife's accountants.

Noting the complexity of Mr. Nygard's circumstances, the inability of Ms. Pakka to fund the income accounting analysis, and the necessity of completing such analysis, the court awarded $35,000.00 in interim disbursements.

Rosenberg v. Rosenberg
(2003), 39 R.F.L. (5th) 403 (Ont. S.C.J.)

In this case, the wife asked for an order for interim disbursements to fund the valuation of her husband's business interests and to perform an analysis of his income. The assets would have to be valued on both the marriage-date and the valuation date. The amount requested was $75,000.00.

The husband was ordered to advance the wife $15,000.00 to fund a valuation of his businesses. The "advance" was in the nature of a loan which, presumably, would have to be retired out of the wife's equalization award.

The husband had delivered an accountant's analysis of his income. However, the wife questioned the methodology employed by the husband's expert (though the judgment did not state what methodology was employed or why it was challenged). Moreover, the wife alleged that it was critical for her to conduct an independent forensic valuation due to the fact that the husband's valuation contained disclaimers to the effect that the authors had not verified the accuracy of the information provided to them. Finally, there had not been an independent valuation of certain real property owned by the business and, as a consequence, there would not be a complete picture of the husband's financial resources at trial.

The court canvassed the factors that would guide the exercise of its discretion in awarding interim disbursements. They would include the merits of the matter, the hardship to the moving party if the relief were not granted, and the ability of the moving party to repay any amounts ordered in the event that the moving party was unsuccessful at trial. In essence, the court noted interim disbursements had been ordered to "level the playing field" in situations where there was a significant disparity between the resources of the parties and where one party lacked sufficient resources to fund the litigation.

The court expressed concern, however, with the valuator's estimate of his fees and disbursements. They lacked specificity. The Court held that it would be incumbent upon the authors of the estimate to provide detailed information as to the investigations to be undertaken, the estimated time involved, the fees, and why the matter would merit such an expense.

Thus, the court could not conclude that $75,000.00 was a justifiable amount. The court did, however, make an award of $15,000.00. The structure of the award was somewhat unusual. It was not an unconditional order for interim disbursements. Rather, the husband was obliged to advance, by way of a loan, the $15,000.00 to the wife. The loan would have to be repaid, presumably, out of the wife's equalization payment.

Palinka v. Palinka
(2004), 124 A.C.W.S. (3d) 749 (Ont. S.C.J.)

Wife's claim for interim disbursements dismissed. There was no evidence demonstrating the need for the award and no evidence quantifying the fees and disbursements of the proposed valuator.

In this case, the wife's claim for interim disbursements was dismissed. Simply put, counsel failed, entirely, to demonstrate the need for an award. There was no particularization of the amount claimed for interim disbursements nor was there an estimate of the anticipated fees and disbursements from the proposed valuator.

Hodgkinson v. Hodgkinson
(2004), 44 R.F.L. (5th) 82 (B.C.S.C.)

The husband's claim for a tax discount in valuing his holding company was dismissed. There was no evidence to indicate that he would be required to collapse the holding company and dividend out the funds to meet his equalization obligation.

The husband was a successful investor and financer. Through his holding company, he would buy and sell business interests or make investments.

The case was decided under British Columbia's *Family Relations Act.* That statute differs, substantially, from Ontario's *Family Law Act*. In any event, after making an equal division, the parties would each end up with approximately $3.3 million in assets. To adjust the division, the husband would be required to make a payment to the wife of $476,000.00. The court disallowed what it described as "distributive taxes" that would be incurred as a result of the husband liquidating his holding company and transferring the net proceeds of liquidation to himself. The court held that there was no evidence that he would have to undergo such a process.

Brophy v. Brophy
(2003), 32 R.F.L. (5th) 1 (Ont. S.C.J.)

The husband and the wife were the owners of a financial services company. The husband owned 75% of the shares and the wife owned 25% of the shares. There was evidence that a competitor had once offered to buy the parties' shares.

The husband's claim for a tax discount was dismissed. In notionally valuing his shares, the likeliest transaction would be a share sale as opposed to an asset sale. On a share sale, the husband would be able to shelter the proceeds with his capital gains exemption.

The husband claimed a notional tax discount alleging that the appropriate valuation technique was to liquidate the assets within the corporation and to pay out a terminal dividend. The dividend would attract personal income tax.

The court rejected this approach. The court noted that the likeliest disposition would be a sale of shares. Having regard to the husband's capital gains exemption, he could escape, entirely, any adverse tax consequences.

Beaumont v. Beaumont
(2003), 123 A.C.W.S. (3d) 503 (Ont. S.C.J.)

In *Beaumont v. Beaumont*, Madam Justice Scott had to determine the value of a locksmith's business. Originally, the husband was the sole shareholder in the corporation. Ultimately, however, the husband's father invested capital and became an equal shareholder in the business.

The evidence to establish the value of the husband's business was contradictory and poorly presented. As a result, the court relied on a past transaction in which the husband bought out his partner to establish value.

Approximately three years prior to the valuation date, as a result of a falling out between father and son, the son bought the father out for $75,000.

Justice Scott commented on the unsatisfactory nature of the evidence at trial.

A report of a business valuator was tendered at the trial. The report specifically stated that it was not a "business valuation" but was, rather, a "calculation of value". The valuator described a value of $16,000 for the business based on a liquidation approach.

The husband called a chartered accountant (not a business valuator) to express an opinion on the fair market value of the husband's business. This accountant made it clear that his report, prepared for the trial, was not a business valuation. He concluded that as the company's net income was exceedingly low and the husband's income was lower than that which a manager (let alone the owner who has invested equity) could earn, there is no value to goodwill. He concluded that the company should be valued at its book value of $23,000.

The wife called a chartered accountant to testify on her behalf. The wife's accountant described the numerous difficulties that he had in obtaining disclosure from the husband. His firm encountered difficulty in accessing the general ledgers to confirm sales. He expressed concern that any valuation could be flawed due to the inability to confirm the income generating power of the corporation because its computer system had become inoperative.

While the wife's accountant did not disagree that a liquidation approach was possible given the low income generated to the owner by the corporation, he questioned the appropriateness of valuing the corporation in this fashion. He placed reliance on the husband's business acumen and his continued commitment to the corporation. He opined that there must be additional value to the husband given the husband's protectiveness and lack of disclosure and given the history of the entire matter.

The court rejected a liquidation approach. In so doing, the court concluded that the limitations on each witness's evidence limited their usefulness to the court. While the court conceded that the calculations employed by the witnesses employed accepted principles within the proper perimeters of the techniques available in the discipline, the court concluded that the reports were mere mathematics.

As a consequence, the court fell back upon the purchase price paid by the husband. It did so noting that the husband testified to the optimism that he felt surrounding the future of the business. The court noted that the husband had no intention of liquidating or disposing of his interest in the corporation. The husband had placed a value on the business not on sentiment but on the merits of the lifestyle that could be maintained and the cash flow that could be generated by control of the corporation.

Kelln v. Walker

(2003), 33 R.F.L. (5th) 91 (Sask. Q.B.)

The value of the husband's interest in a corporation was established by a prior transaction. He sold his shares to family members after having received valuation advice.

Several years earlier, a number of family members had a falling out in relation to their agri-business. Litigation followed. The parties engaged an expert to value the corporation and the husband ultimately negotiated a settlement of his interest in the corporation.

In subsequent matrimonial proceedings, the court concluded that the sale price, negotiated by the husband, with expert evidence, represented the best evidence of value.

Aguanno v. Aguanno
(2003), 113 A.C.W.S. (3d) 308 (Ont. S.C.J.)

The court accepted the husband's expert opinion that the business was worth $33,000.00. His wife did not call an expert but argued that the husband had, a few years earlier, bought out his partner for $25,000.00. She argued, therefore, that the business had a value of $50,000.00.

The husband had previously bought out a partner. The court refused to use this transaction as the measurement of value. Rather the court accepted the opinion of the business valuator.

The court noted that the buy-out was done without expert advice or appraisals. Thus, it could not be used as an indicator of fair market value. The court specifically commented on the wife's failure to call her own expert if she wished to contradict the opinion of value expressed by the husband's expert.

Purvis v. Purvis
(2003), 48 R.F.L. (5th) 368

Following a trial, which occurred in the year 2000, the husband was left owing his wife $92,838.88. The court ordered that certain building lots owned by the husband should be sold to satisfy his obligation to his wife under the judgment. It had been common ground, between the parties, that the lots had a value of $125,000.00. There had been some suggestion, at the trial, that the land may have been contaminated as a result of the leakage of gas from a buried gas tank on the property.

Once a judgment for equalization has been pronounced, it cannot be re-opened on the basis that the original valuations were incorrect.

Subsequently, conditional offers (relating to environmental testing) were made. The price ranged between $65,000.00 and $105,000.00.

Ultimately, an unconditional offer of $70,000.00 was made.

The husband argued that he should not be forced to sell the property for $70,000.00 unless the equalization judgment was reduced by $27,500.00 - namely, half the amount of the over estimate of value.

The husband's position was rejected by the court.

In so doing, the court recognized the importance of the legal doctrine of *res judicata*. That doctrine prohibits the re-litigation of matters that have been decided. It requires that the parties put forward their entire case in a single action.

Cade v. Rotstein
(2004), 50 R.F.L. (5th) 280

An inter-family loan can be discounted to reflect the likelihood that it will never be repaid.

Over the years, the husband's parents had advanced money to the parties, primarily to acquire matrimonial homes. The total advances, over the years, amounted to $192,000.00. The trial judge concluded that there was little expectation of repayment. He noted that no demand had ever been made upon the parties except for one - and that demand was motivated by the separation. The trial judge discounted the debt to 5% of its actual value, concluding that there was little likelihood that the husband would ever be called upon to pay.

The trial judge was affirmed by the Ontario Court of Appeal. The court specifically approved of the practice of discounting debts originally established in the case of *Poole v. Poole* (2001), 16 R.F.L. (5th) 397 (Ont. S.C.J.) and specifically approved the following passage from the *Poole* case:

> Even though a debt may have a specified face value, if the evidence indicates that it is unlikely that the promissor will ever be called upon to repay the debt, the value of the debt should be discounted to reflect that reality.

Fitzpatrick v. Fitzpatrick
(2004), 3 R.F.L. (6th) 325 (Ont. S.C.J.)

The concept of "value" in Ontario's *Family Law Act is* not restricted to "fair market value". "Value" must be determined on the particular facts and circumstances found and developed on the evidence in each individual case.

Where a spouse owns a minority interest in a corporation, there should be no special purchaser premium.

A transaction subsequent to the valuation date may be looked upon to establish evidence of value without offending the hindsight evidence rule. The use of such a transaction, however, is limited to confirming valuation. It may not be used to establish valuation.

In *Fitzpatrick v. Fitzpatrick* (2004), 3 R.F.L. (6th) 325 (Ont. S.C.J.), Justice David Aston was called upon to value the husband's minority interest in an insurance agency referred to as BLI. Because of the duration of the marriage and the economic disadvantage suffered by Mrs. Fitzpatrick, he was also called upon to determine the issue of spousal support. Each of the husband and the wife called, as witnesses, their own business valuators.

BLI had four principals in 1998. They developed a strategic plan which included an aggressive acquisition program. In 1998 and 1999, BLI acquired two agencies.

During the latter part of the same period, it conducted negotiations with an insurance company known as Lombard Canada. Lombard Canada was interested in acquiring a minority interest in BLI, but negotiations broke off in May of 1999 as the parties could not agree on price. Finally, in the summer of 1999, BLI was engaged in negotiating a financing package with the Bank of Montreal which was completed in August of 1999, on terms very favourable to BLI.

The parties separated on September 30, 1999. In early 2000, the principals of BLI each sold a portion of their shareholding to Lombard Canada. The price was significantly above what Lombard had been prepared to pay in May of 1999 when negotiations had broken off.

An expert must be neutral, objective and independent. The expert's testimony will be discounted if it appears that he or she is an advocate for a party or fixed in his or her views.

Actual sales are very important in the valuation process but are not determinative as to valuation.

If a party is precluded from disposing of an asset, such as a business, the value of the asset may be discounted to reflect the time lapse between the valuation date and the likely date of disposition.

The husband's valuator had, originally, been engaged by Lombard Canada as its advisor. Justice Aston noted that the terms of his original retainer led him to be very cautious and conservative in his valuation approach.

The wife's valuator placed a very high value on the company. He noted that at the valuation date, there were other companies aggressively pursuing acquisitions. Thus, he felt that the company should carry a special purchaser premium.

a) Fair Value

In directing himself, Justice Aston noted that the *Family Law Act* does not define "value" as "fair market value". In so doing, he quoted, at length, from the earlier decision of *Menage v. Hedges* (1987), 8 R.F.L. (3d) 225 (Ont. U.F. Ct.):

> I am satisfied that when the *Family Law Act* uses the term "value" it refers to the expression in terms of money of the desirability of the ownership of a particular item of property. This desirability of ownership may be measured in many different ways depending on the goal sought to be achieved. Because value is a word of so many meanings, accounting principles have to be looked at to determine how to assess the exchange value of assets. Book value, going concern value, liquidation value, value in use, market value, fair market value, value to owner, intrinsic value, investment value, fair value, are all accounting concepts having a direct bearing on the eventual result of the valuation process. The legislator did not specify which of these accounting approaches was to be preferred because none of these approaches, by itself, can achieve the goals outlined in …the *Family Law Act*. The Act was passed to facilitate "the orderly and equitable settlement of the affairs of the spouses upon a breakdown of the partnership.

Justice Aston also noted that there is no definition of the word "value" in the *Family Law Act*. He cited *Rawluk v. Rawluk* (1986), 3 R.F.L. (3d) 113 at p. 122, wherein the Court stated:

> While the Act speaks of value, it contains no definition of that term or, indeed, guidelines of any kind to assist in the determination of its meaning....Absent any statutory direction, "value" must then be determined on the peculiar facts and circumstances as they are found and developed on the evidence in each individual case. While this approach does not lead to uniformity and predictability of result, it does recognize the individuality inherent in each marriage and case and permit the flexibility so often necessary to ensure an equitable result.

b) Special Purchasers

In *Fitzpatrick*, the husband owned 25% of the shares of an operating company. There was evidence that there were special purchasers and the wife's valuator attached a special purchaser premium to the value of the overall company. Despite that evidence, the Court rejected any special purchaser premium. The husband's interest was a minority interest only. The Court concluded that no special purchaser would be interested in a minority interest. Finally, there was no evidence that the entire business was up for sale on the valuation date.

c) Hindsight Evidence

In determining the value of the husband's shares, Justice Aston looked at the price that Lombard Canada paid, albeit several months later. In so doing, the judge did not employ hindsight evidence. Rather, he looked at the subsequent transaction as evidence confirmatory of the value on the valuation date. The price ultimately paid by Lombard Canada took into account new factors which existed on the valuation date, but which did not exist when negotiations were broken off. These included the completion of certain acquisitions and very favourable financing terms that BLI had negotiated.

d) The role of the expert

The role of an expert witness was discussed, recently, in a legal malpractice action known as *Ristimaki v. Cooper* (2004), 131 A.C.W.S. (3d) 1159 (Ont. S.C.J.). An expert witness must be neutral, objective, independent, and not an advocate for a party.

In discounting the testimony of one of the experts, Justice Aston had the following to say:

> "...his unwillingness to temper his conclusions undermines his credibility as an independent and impartial witness. He became a staunch advocate of his own opinion. I had the clear impression his goal was to defend an outcome he was committed to, at the expense of objectivity".

e) Evidence of actual sales

Justice Aston noted the importance of actual sales in arriving at value. It is clear, however, that he did not believe that actual sales were determinative of value. He was willing to accept that one of the acquisitions that BLI made (the consideration being the issuance of BLI shares) may have occurred at a price that exceeded market value. He used the consequent actual sale to Lombard Canada as a measuring post against which he could assess the evidence of the experts at trial.

f) The time discount

In the valuation process, the Courts will assume that the owner will notionally sell on terms that would maximize value – such as staying on after the sale to introduce customers to the new owner or giving a non-competition covenant: *Deguire v. Deguire* (1997), 34 R.F.L. (4th) 164 (Ont. Ct. (Gen. Div.)).

Due to the *Fitzpatrick* case, this concept may undergo re-evaluation by the Courts in the years ahead because of the inherent inconsistency of the valuation approach to the practical realities of the situation. In family law proceedings, spousal support is often at issue. It seems inherently contradictory to value the business as if the owner would covenant not to compete, yet, at the same time, determine his or her capacity to pay support on the basis that the business is still being carried on.

After reaching his opinion of value, Justice Aston took into account future notional tax and disposition costs. They were discounted to present value, assuming that the husband would retire at the age of 60 or soon thereafter. This discounting has long standing approval of the Ontario Court of Appeal.

The most unusual part of the case, however, was the discount that Justice Aston then applied to the asset value. Justice Aston noted that the husband would not dispose of his shares in BLI prior to his retirement. On that basis, he would not be able to realize their value for years to come. In the same fashion as the liabilities were discounted, Justice Aston discounted the asset value. In so doing, Justice Aston had the following to say:

> "This case is not a theoretical exercise. In my view, a just outcome should reflect the actual facts of the case, not a hypothetical construct. Because it is clear on the evidence Mr. Fitzpatrick will not retire before the age of 60, the valuation of his business perhaps should be discounted to reflect the deferred realization of that asset. He has the ability to pay substantial spousal support because he retains his interest in the business. Unlike other assets, a disposition of his ownership in the business would constitute a disposition of his job as well."

A spouse who fails to account for large sums of money passing through his or her hands at or about the valuation date, may have assets "imputed" to him or her in the determination of net family property.

A spouse who stonewalls the other spouse or that spouse's valuator runs the risk that the court will draw adverse inferences against him or her.

The court selected different earnings multiples for the date of marriage and the date of separation even though those two dates were only fourteen months apart.

Debora v. Debora

(2004), 135 A.C.W.S. (3d) 447

At the time of trial, the parties were in their early 50's. They had both been previously married. The husband was a widower and the wife was divorced.

They began to live together in December of 1986. They went through a form of religious marriage on April 3, 1987. They had not obtained a marriage license and both realized that the marriage may not have legal effect. It was done intentionally so that the husband would not lose his widower's pension.

The parties married each other in a civil ceremony on July 20, 1994. They separated on September 11, 1995. Thus, cohabitation lasted for 9 years, although only 14 months of that period was marital cohabitation. In 1999, the Ontario Court of Appeal ruled that for the purposes of computing net family property, the date of marriage was the date of the civil ceremony in 1994 and not the date of the religious ceremony in 1987.

In 1989, the husband founded a company known as Lifestyles. The corporation was described as a multilevel marketing company making diet products and neutraceuticals from a product called "intra". "Intra" was an ingredient made of herbs and grape juice. The company was profitable from the outset, earning $1,000,000 in profits in its first year of operation.

The litigation, which took 8 years from commencement to trial, was long and arduous. By trial, the wife had spent $600,000 on lawyers and owed her current lawyers $250,000. She had spent between $80,000 and $100,000 in forensic accounting fees and owed her accountants $362,000. The wife's valuator, who had been involved in the litigation from its inception, had spent 1,000 hours personally while his firm spent another 1,000 hours in research, obtaining information and documentation, analysis, the preparation of reports, and preparation for trial.

The wife's valuator filed a number of reports, the most important of which were:

a) an opinion with respect to assets which, in that valuator's opinion, the husband had failed to include in his net family property on the valuation date;
b) an opinion of value as to the husband's business interests; and
c) an opinion as to the husband's income.

The judge specifically noted that the husband's evidence lacked credibility and that he failed to make full and accurate disclosure.

The wife's valuator expressed an opinion that the husband had failed to disclose assets, existing on the valuation date, amounting to $4,179,297. The judge accepted, in its entirety, the wife's valuator's analysis. Included in the undisclosed assets were:

1) The Boatman's National Bank cheque

On February 15, 1996 (five months following the separation), the husband's shareholder's loan account was credited with $900,000 U.S. (approximately $1,208,610 Cdn.). Requests for information and bank records went unanswered. At trial, the husband could offer no further information. The court drew an adverse inference against the husband and concluded that this amount must have existed, albeit in a different form, on the valuation date.

2) CCRA reassessment

As a result of a CCRA reassessment, it was determined that Lifestyles had failed to report $2,022,877 in sales. CCRA assumed that the money had been earned equally over each of the four years. Accordingly, the wife's valuator added $583,263 to the company's income ($509,561 for the year-ended July 31, 1995 and $73,702 pro-rated to September 11, 1995). He testified that that amount should form part of the value of the corporation, and, therefore, part of the husband's net family property. The judge accepted his testimony.

3) Mercantile Bank cheques

The wife's valuator indicated that $300,000 U.S. had been deposited in the husband's name at the Mercantile Bank. It was incorrectly deducted as expenses on the books of Lifestyles as "product purchased". In February of 1995, the husband wrote a cheque on the account payable to himself in the amount of $300,000. When pressed as to what happened to these funds, the husband offered no explanation despite numerous requests. Once again, the court was prepared to draw an adverse inference against the husband for failing to trace the funds. The court assumed that they existed on the valuation date and added $402,870 to the husband's net family property.

On March 7, 1995, a cheque for $250,000 U.S. was drawn on the husband's Mercantile Bank account. Pending trial, the husband was asked to provide information regarding who cashed the cheque, where it was deposited, and how it was accounted for. All inquiries went unanswered. The court made an adverse inference and concluded that the husband had funds totalling $335,725 Cdn., in undisclosed assets, on the valuation date.

4) Lifestyles' cheques

The wife's accountant discovered 11 cheques made out to "Lifestyles International" totalling $181,919 U.S., predating the date of separation (in 1995). Lifestyles International, however, was not incorporated until 1997.

The wife's valuator sought production of these cheques, front and back, to determine where the funds had actually gone. No answer was ever given. Once again, the court drew adverse inferences against the husband and concluded that $244,299 Cdn. should be added to his net family property.

5) Shareholder's advance

$500,000 U.S. was deposited to the husband's shareholder account on February 12, 1996 in the name of the husband's mother. The husband conceded, at trial, that this was not his mother's money but was his own. He was not able to advise where the money came from, whether tax had been paid on it, or whether it existed on the date of separation. Again, drawing an adverse inference against the husband, $671,450 Cdn. was added to his net family property.

6) Missing account #1102761

The husband wrote a cheque on his Mercantile Bank account on August 18, 1995 payable to "Lifestyles". The cheque cleared the bank on September 11, 1995 (the valuation date) and was deposited to account #1102761. The husband attempted to assert that the cheque was payable to the American subsidiary of Lifestyles. However, he never produced the bank records for account 1102761 and it could not be ascertained if the funds were reflected on the U.S. subsidiary's financial statements. Again, drawing an adverse inference against the husband, the court added $733,080 to the husband's net family property.

On both the date of the civil marriage (July 20, 1994) and the date of separation (September 11, 1995), the husband owned 100% of the shares of 4 different companies. Lifestyles Canada Limited was the main operating company that oversaw the manufacture of Lifestyles' product and was responsible for world wide purchasing and distribution. Lifestyles Euro Limited and Lifestyles U.S.A. Inc. were essentially "warehouse operations". They secured their products from Lifestyles Canada and distributed them within their respective jurisdictions. Lifestyles Canada had its own network of distributors. Harvest Valley Bakery, another company, did not loom large in the case.

There were disagreements between the valuators in connection with the maintainable earnings of Lifestyles. They were as follows:

1. Plaza Corporation

The wife's valuator, upon reviewing the CCRA file, noted that a $500,000 U.S. payment had been incorrectly deducted by Lifestyles U.S.A., in 1995, as management fees when they were, in reality, investments. As a result, he re-constituted the tangible asset backing and the maintainable earnings for the corporation for 1995 on the basis that this investment existed on the date of separation. The husband's valuator agreed but stated that the adjustment should be $220,000. In the end result, this adjustment, alone, added $1.2 million dollars to the value of the company.

2. Interest income

The wife's valuator testified that interest income was a component of operations and that there were no redundant assets. Thus, he reasoned, the interest was properly includable. The husband's valuator testified that a potential purchaser would be expected to utilize the cash and marketable securities from which the interest income was derived to repay the liabilities and the shareholder advances. This accounted for a difference between the two valuators at the separation date of $313,000 before tax in maintainable earnings. The court accepted the husband's valuator's position.

3. Mercantile Bank

The husband had a personal bank account at the Mercantile Bank. The wife's valuator found monies transferred into the husband's bank account from Lifestyles and incorrectly booked as expenses. He concluded that $420,000 could not be accounted for by business use in fiscal 1994 and $1,341,115 could not be accounted for by business use in fiscal 1995. These amounts were in addition to the CCRA re-assessment. He testified that the earnings for these two years were understated by those two amounts. The court agreed and added them back to determine the company's maintainable earnings.

4. IMD Promotion Fund

In 1994 and 1995, Lifestyles established a reserve known as the "IMD Promotion Fund". This was the only expense for which Lifestyles ever created a reserve, the effect of which was to reduce the value of Lifestyles Canada at the valuation date, although the expense had not been incurred at that date. The fund went from $5,000 in 1994 to $500,000 in 1995. In 1996, the reserve was eradicated by a series of journal entries. The wife's valuator testified that the reserves should be added back into the company's maintainable earnings. His position was accepted by the court.

The husband's valuator concluded that the corporation had maintainable after-tax income on both the marriage date and the date of separation to be $4,000,000. The wife's valuator, concluded that the maintainable after-tax earnings, on both dates, was between $4.7 and $5.3 million. As mentioned earlier, the court concluded that the interest income of $313,000 should not be included in the maintainable earnings. Thus, the court concluded that the maintainable earnings would be from $4.5 million to $5.1 million after-tax.

In order to determine the value of the company, both valuators applied a multiple to the maintainable after-tax earnings of the company. The biggest difference between them was their choice of multiple. The husband's valuator applied a multiple of 3.5 to 4.0 to the maintainable earnings at both the marriage date and the date of separation. The wife's valuator applied a multiple of 2.75 to 3.0 on the date of marriage but a multiple of 4.0 to 4.25 on the date of separation (some 14 months later).

The wife's valuator testified that between 1992 and 1994, the cash flows achieved by Lifestyles were risky ones. In selecting multiples at the date of marriage, he was influenced by the trend of revenue experienced by the company (increasing to 1993 and jumping in 1994), the lack of a track record for sales and earnings at the lofty level experienced during fiscal 1994, and pending charges against Lifestyles Canada under the *Competition Act*.

The *Competition Act* took effect on January 1, 1993. Lifestyles and three of its major distributors had been charged with offences under the statute in early 1994. It appeared that the federal prosecutor was seeking a substantial fine on behalf of Lifestyles as well as convictions against the distributors. At the date of the civil marriage, July 20, 1994, the proceedings were pending and unresolved.

Approximately a month after the marriage, the prosecution was settled. Lifestyles paid a nominal fine and the charges against the distributors were withdrawn.

The wife's valuator considered the pending prosecution, the uncertainty about the financial penalty, and the effect of an unfavourable judgment on the company's distribution network reason to choose a lower multiple on the date of marriage. In his opinion, the decrease in risk relating to the settlement of the charges and the withdrawal of the charges against the distributors justified a higher multiple at the date of separation.

The husband's valuator did not consider the charges to be a substantial impediment to value. He testified that the most that could be attributed to the charges was $2.2 million as that was the maximum fine under the *Competition Act*. He testified that on a sale, these types of pending charges would normally be dealt with through a price adjustment agreement or indemnification agreement.

As previously stated, the wife's valuator selected a multiple of 2.75 to 3.0 for the date of marriage and 4.0 to 4.25 for the date of separation.

In the end, the court accepted the multiples of the wife's valuator. The judge considered the impact of the charges and their ultimate resolution to be of substantial significance prior to and following the date of marriage. Moreover, in 1995 the company had a huge increase in profits. She also noted that profits, in the early 1990's, had flattened out. They rose sharply in 1994 and increased, dramatically, in 1995. The court concluded that a further year of sustained profitability would have allayed concerns in a potential buyer that the 1994 profits could not be repeated. This fact also warranted a higher multiple on the date of separation.

Finally, for income tax purposes, Lifestyles was classified as a trader. It had unrealized losses of $450,000 on the date of marriage and $1,600,000 on the date of separation.

The valuators disagreed on the notional sale. The wife's valuator assumed a sale of assets. The husband's valuator assumed a share sale. The court, accepted, without giving reasons, that the notional sale would be an asset sale.
Unfortunately, the net family property calculations do not form part of the reasons for judgment. It would appear, however, that in valuing the husband's shareholdings, the court applied different multiples for the date of separation and marriage, added the notional capital injections to the date of separation value,

and added the present value of the future tax savings to both the date of marriage and date of separation values. From this, the court deducted contingent corporate and personal taxes, assuming a sale of assets.

With respect to child support, the wife simply requested that the interim order of $23,000 monthly be continued irrespective of whether it was for one child or two children. Because of this, it was unnecessary for the court to make a precise calculation of the husband's income. The court did speculate, however, that the husband's income likely exceeded $3,000,000 tax free per year which would equate to a taxable income of $5.5 million annually.

David v. David, unreported

December 8, 2004, Ohah J. (Ont. S.C.J.)

The court had to determine the value of a dental practice having a high ethnic patient base.

The court was required to value a dental practice in Thornhill, Ontario. After the valuation date, the dentist/husband opened up two additional practices which were serviced by associates. Although the wife alleged that the husband had substantial unreported cash revenues and that he diverted many of his old patients to the associates and his new practices, the court rejected both allegations.

Originally, the parties jointly engaged a business broker familiar with the sales of and valuations of dental practices. He conducted a detailed examination of the dental practice, personally attending at the practice and conducting interviews of the dentist and his staff. He reviewed patient charts and sampled 10% of the charts. He compared the value of the husband's practice with 8 similar practices sold that had an ethnic composition in the same geographic vicinity.

The wife engaged a business broker and professional practice appraiser. The wife's expert provided a limited scope letter of opinion. He relied solely on the appraisal prepared by the husband's expert. In cross-examination, he admitted that:

a) he had never spoken to the original appraiser;
b) he never attended at the practice;
c) he never reviewed the patient records;
d) he never saw the location of the practice;
e) he never checked the equipment;
f) he never interviewed the associates and,
g) he did not have a knowledge of the patient base.

The wife's expert would have valued goodwill by applying a standard 15% capitalization rate on the after-tax net cash flow.

The husband's expert would have applied a 19% capitalization rate. He felt there were a number of factors which created a higher risk for a purchaser. Amongst those factors were:

1) There was a very high Romanian component to the patient base. Up to 60% of the patients were Romanian. Thus, the practice would only be of interest to Romanian speaking dentists.

2) The patient base was limited to 510 recall patients. This, in the expert's opinion, was less than half a full-time practice patient-base.

3) The billings per patient were exceedingly high, creating high risk to a purchaser.

4) The associates were paid 50% of net billings as opposed to the going rate of 40%. This would limit the net income to the business owner. However, payment of a greater percentage rate was likely necessary to attract Eastern European speaking dentists to treat the patient base.

5) There were negatives in respect of the business location. There were five other dentists in the building with two of them on the main floor. The subject practice was on the second floor and had limited visibility.

6) Finally, the practice was not computerized.

What troubled the court was the undisputed evidence that the husband had sold a previous practice, several years earlier, which had a goodwill value of $215,000. The court noted that both the current practice and the prior practice used the same management style and similar office protocols. Both practices had a high Romanian patient base.

The court valued the practice at the mid-point between each appraiser's value.