A CRITICAL ANALYSIS OF THE VALUATION OF PROFESSIONAL PRACTICE INTERESTS UNDER THE PROPERTY (RELATIONSHIPS) ACT 1976

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INTRODUCTION

When relationships between spouses or de facto partners end it is typically a time of significant change and emotional upheaval in a person's life.[1] Furthermore, the division and associated valuation of relationship property is often a difficult task which can cause further disagreement and tension between parties.

The division of relationship property is governed by the Property (Relationships) Act 1976 (the PRA). One of the PRA's legislative purposes is to provide for the just division of relationship property between spouses or partners when their relationship ends on separation or death.[2] To guide the achievement of this purpose, s 1N(d) of the PRA states that questions arising under the PRA should be resolved as inexpensively, simply and speedily as is consistent with justice.

However, the valuation of professional practice interests under the PRA is currently inconsistent with the Act's purposes and principles. This is particularly so with regards to providing for a just division in a cost-effective manner.[3] Rather, the overly discretionary valuation approach produces uncertainty and unfairness often leading to "protracted and messy court battles, which chew up hundreds of thousands of dollars in legal fees."[4]

This and other issues with the PRA that permeate our legal system have prompted the current review of the PRA by the Law Commission.[5] This dissertation will critically analyse the current approach to the valuation of professional practice interests in New Zealand under the PRA.

Chapter one will examine the valuation of property in the PRA's overall scheme. This will outline the framework and principles that govern the valuation of property under the PRA.

Chapter two will examine the current state of play of the law governing the valuation of professional practice interests. This will involve an exploration of the current law as developed

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[1] Law Commission *Dividing relationship property – time for a change?* (NZLC IP41, 2017) at 11.
[2] Property (Relationships) Act 1976, s 1M(c).
[3] See Property (Relationships) Act, ss 1M(c) and 1N(d).
[4] Nikki Macdonald " Do our relationship property sharing laws need a radical shake-up" (11 February 2017) Stuff <https://www.stuff.co.nz/life-style/home-property/88837125/do-our-relationship-property-sharing-laws-need-a-radical-shakeup>.
[5] See Law Commission, above n 1.

by the New Zealand courts. In particular, this chapter will provide an in-depth analysis of the issues faced in the recent Supreme Court decision of *Scott v Williams* when valuing an interest in a professional practice.[6]

Chapter three will seek the illustrate the issues with the current valuation approach to professional practice interests taken by the New Zealand courts including why it is not currently ensuring a division of relationship property in line with the purpose and principles of the PRA.

The final part of the analysis, chapter four, will be the exploration of potential options for reform to address the current issues identified. This is a balancing exercise. On the one hand we must consider the desire to prescribe greater detail as to how property should be valued in order to ensure that relationship property disputes are resolved consistently, quickly and cost-effectively. On the other we must consider the danger that the proposed reform is too prescriptive and inflexible, therefore jeopardises the court's ability to arrive at a value that is fair in the circumstances of each case. Whilst there is no silver bullet to solving valuation disputes under the PRA this dissertation will seek to provide straightforward and practical options for reform that will aid the valuation of professional practice interests in the future.

[6] *Scott v Williams* [2017] NZSC 185.

CHAPTER ONE: VALUATION OF PROPERTY UNDER THE PRA

1.1 Introduction

In order to understand the existing framework for the valuation of professional practice interests in relationship property disputes it is necessary to first set out the valuation of property generally under the PRA's overall scheme. This forms the foundations on which the law governing the valuation of professional practice interests is built upon.

1.2 Introduction to the PRA

The PRA was enacted in 1976 and is a pivotal piece of social legislation in New Zealand.[7] The PRA contains rules for the division of property when a relationship ends as a result of separation or the death of one of the partners to the relationship.[8] The PRA is heavily embedded in social policy with the aim of ensuring a just division of property upon separation.[9] This policy is manifested in the statutory purpose and principles under ss 1M and 1N of the Act.

The PRA recognises all contributions, financial or non-financial, to a marriage or de facto relationship and treats these relationships as an equal partnership.[10] The general rule is that on division of relationship property each of the spouses or partners is entitled to share equally.[11]

The equal sharing regime has meant the PRA is often described by commentators as a "community of property" system. [12] In other words, all relationship property is treated as the joint property of both partners to the relationship. This however has two important qualifications. The first is that the PRA will only apply to property that qualifies under the s 2

[7] The Property (Relationships) Act was enacted as the Matrimonial Property Act 1976. The name of the Act was amended on 1 February 2002 by s 5(2) of the Property (Relationships) Amendment Act 2001. See also Mark Henaghan and Bill Atkin *Family Law Policy in New Zealand* (4th ed, Lexis Nexis, Wellington, 2013).
[8] The PRA will apply on separation or death unless the spouses or partners otherwise agree to opt out of the regime.
[9] Law Commission *Dividing relationship property – time for a change?*, above n 1, at 1. This is particularly so since the Property (Relationships) Amendment Act 2001 which made significant changes to the Act.
[10] Property (Relationships) Act, ss 1M and 1N. See also Joanna Miles "Financial Provision and Property Division on Relationship Breakdown: A Theoretical Analysis of the New Zealand Legislation" (2004) 21 NZULR 268 at 275 and 292–293.
[11] Property (Relationships) Act, s 11.
[12] A Angelo and W Atkin "A Conceptual and Structural Overview of the Matrimonial Property Act 1976" (1977) 7 NZULR 237 at 258.

definition of property.[13] Secondly the PRA is a deferred regime and therefore only applies on separation or once a partner of the relationship has died.[14]

1.3 Purpose of valuation under the PRA

Typically, there is a global division of relationship property under the PRA.[15] The court will identify the totality of assets and debts that make up the relationship property pool followed by an appropriation of specific assets to one or the other party to the relationship with monetary adjustments as required to ensure equal sharing.[16] To do so the court must determine the net monetary value of the assets and debt in the relationship property pool. The valuation of relationship property therefore lies at the very crux of the PRA and is integral to ensuring the just division of the relationship property between the partners of a relationship. These sentiments were summarised by the Court of Appeal in *Reid v Reid*:[17]

> The overall purpose of having various assets valued is to produce in a global sense a fair estimation of the worth of the matrimonial property so that its subsequent division will be achieved in a way which will be just as between the husband and the wife.

Similarly, Glazebrook J in *Scott v Williams* commented:[18]

> The aim of any valuation exercise in this context is to ensure a fair and just division of relationship property, in line with the principles and purpose of the PRA.

These statements illustrate that the valuation of relationship property under the PRA is primarily concerned with the justness of the division of property between the partners of a relationship in line with the purpose and principles of the PRA, rather than the scientific certainty of the valuation exercise.[19]

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[13] Law Commission, above n 1, at 269.
[14] Law Commission, above n 1, at 58. See also s 61 of the Property (Relationships) Act which states that a surviving spouse or partner may choose between division of relationship property under the Property (Relationships) Act and taking under will or intestacy.
[15] Law Commission, above n 1, at 268.
[16] Simon Jefferson and Paul Moriarty "Valuation of Relationship Property: An Evaluation of Practice and Procedure" in Jessica Palmer, Nicola Peart, Margaret Briggs and Mark Henaghan (eds) *Law and Policy in Modern Family Finance* (1st ed, Intersentia, Cambridge, 2017) at 232.
[17] *Reid v Reid* [1980] 2 NZLR 270 (CA) at 272. The reference in the quotation to matrimonial property should now be read as relationship property.
[18] At [99].
[19] Jefferson and Moriarty, above n 16, at 233.

1.4 Determining value under the PRA

The valuation of relationship property under the PRA is an inherently difficult exercise. This is primarily because the Act is silent on the definition of value and gives no guidance on the valuation methodology to be used.

1.4.1 Standard of value

The term value, used frequently throughout the PRA although not defined, is one that has multiple meanings.[20] As Richardson J commented in *Haldane v Haldane*, the term may be used in the sense of market value, value to the owner, intrinsic value, replacement cost or historical cost.[21] After the enactment of the PRA in 1976 the courts were faced with the difficult task of interpreting the multi-faceted term and the principles to be applied in the valuation of relationship property. [22] Unsurprisingly a number of cases promptly found their way to the courts.[23]

When valuing relationship property under the PRA the court must determine the appropriate standard of value.[24] The Court of Appeal in *Hatrick v Commissioner of Inland Revenue* established that the fundamental test for valuing an asset is the "value at which a willing but not anxious vendor would sell and a willing but not anxious purchaser would buy."[25] This standard of value is known as fair market value. This formulation was later adopted in the context of relationship property valuation. In *Haldane v Haldane*, Richardson J, when valuing a superannuation scheme, states that a just division between the spouses of relationship property "will ordinarily best be achieved on the basis of a hypothetical sale by a willing but not anxious seller to a willing but not anxious buyer."[26] This is a hypothetical exercise and can involve certain assumptions as apart from the particular circumstances of the case.[27] These

[20] Shelley Griffiths "Valuing "bundles of rights" for the Property (Relationships) Act 1976; when neither art nor science is enough" (2011) 7 NZFLJ 98 at 98. See also RL Fisher (ed) *Fisher on Matrimonial and Relationship Property* (online loose-leaf ed, LexisNexis) at 10.11.
[21] *Haldane v Haldane* [1981] 1 NZLR 554 (CA) at 562.
[22] Law Commission, above n 1, at 269.
[23] See *Haldane v Haldane*, above n 24; *Holt v Holt* [1987] 1 NZLR 85 (CA); *Callaghan v Callaghan* [1988] 4 NZFLR 584; and *Clark v Clark* [1988] 4 NZFLR 595.

[24] Law Commission, above n 1, at 269.
[25] *Hatrick v Commissioner of Inland Revenue* [1963] NZLR 641 (CA) at 661.
[26] At 562.
[27] *Holt v Holt*, above n 23.

assumptions include "the existence of a notional market based on the economic conditions prevailing at the market date and also that the property would be on the market for a reasonable period."[28] Furthermore the owner spouse must be included as a hypothetical buyer.[29] Since the judgment of *Haldane v Haldane*, fair market value has subsequently been the standard of value most commonly adopted in relationship property cases.[30]

Fair market value is not the only standard of value the courts have considered. The use of a fair value standard has also been contemplated. However, there is a significant lack of judicial guidance on its use. Fair value was recently described by the Supreme Court:[31]

> Fair value is… "based upon the desire to be equitable to both parties" by recognising that the transaction is not on an open market. It assumes the bringing together of a buyer and seller without other potential parties involved. At a minimum, it involves taking into account what the seller gives up and what the buyer acquires.

The use of fair value was contemplated in regard to the valuation of professional practice interests. In *Scott v Williams* it was argued that a partnership interest in a legal practice held by Mr Williams should be valued at fair value as opposed to fair market value.[32] Glazebrook J commented that in order to ensure a fair and just division of relationship property this may require, in cases where there is no market, that a fair value standard be employed.[33] However, the majority left the issue open due to a lack of evidential basis to determine whether the fair value standard was required to be applied to the valuation.[34]

Glazebrook J did remark however, that in many cases there is unlikely to be a significant difference between fair value and fair market value standard when valuing professional practice interests because under the fair market value standard a restraint of trade is assumed, the retaining partner is considered a potential purchaser and the amount the couple would pay to

[28] *Scott v Williams*, above n 6, at [97].
[29] *Scott v Williams*, above n 6, at [426].
[30] See Fisher, above n 20, at 10.9; and Nicola Peart (ed) *Brookers Family Law – Family Property* (online looseleaf ed, Thomson Reuters) at [PR2G.06].
[31] *Scott v Williams*, above n 6, at [98].
[32] At [91].
[33] At [99].
[34] At at [99] per Glazebrook J, [277] per Arnold J, [330] per Elias CJ and [367] per O'Regan J.

retain the business is assessed.[35] As such, further consideration of the standard of value that should be adopted when valuing professional practice interests is outside the scope of this dissertation.

1.4.2 Valuation methodologies

The PRA is also silent on the valuation methodology to be used to determine value.[36] There are no specific rules as to valuation in relationship property disputes.[37] Given the multiple available approaches to valuation it is essential to address the question within the context of the statutory purpose.[38] The courts have on a number of occasions proclaimed that no specific methodology should elevated into a test for determining value as the appropriate methodology will depend on the circumstances of the case.[39] Instead valuation methodologies should be used as an aid to the court to guide a fair and just division.[40]

It is useful to briefly outline the common methodologies for valuing financial assets to understand the differing methodologies available to an expert valuer. The common valuation methodologies for valuing financial assets are:[41]

1. Income-based valuations
2. Asset-based valuations
3. Comparative valuations

Where a business is a going concern and not asset dependent, income-based approaches will be most relevant. The most widely accepted income-based valuation methodology is that of discounted cash flow.[42] Discounted cash flow analysis calculates the present value of future

[35] At [137] per Glazebrook J. See also *Fong and Chong v Wong and Fong* [2010] NZSC 120 where the Supreme Court, when undertaking the valuation of company shares, suggested that there may be scope for argument as to what if any difference there is between fair market value and fair value; and Allan McRae and Jai Basrur "Valuations of Unlisted Shares – is there a difference between Fair Market Value and Fair Value?" *NZ Lawyer* (online ed, Auckland, 15 November 2011).
[36] Griffiths, above n 20, at 98. See also Law Commission, above n 1, at 270.
[37] *Holt v Holt*, above n 23.
[38] Fisher, above n 24, at 10.11.
[39] *Scott v Williams*, above n 6, at [105].
[40] *Scott v Williams*, above n 6, at [108]. See also Law Commission, above n 1, at 270.
[41] Brendan Lyne and Robyn von Keisenberg "Valuation and Expert Financial Evidence in PRA Cases" (New Zealand Law Society Seminar, June 2016) at 35.
[42] Griffiths, above n 20, at 99.

forecast cash flows over a defined period and adds the present value of any residual value of the business.[43]

Another common income-based valuation is the capitalisation of earnings approach which assumes that one year's earnings, referred to as the future maintainable earnings, will be generated by the business in perpetuity.[44] These future maintainable earnings are then capitalised using a rate based on an assessment of risk.[45] The method is particularly useful when earnings or growth in earnings are relatively constant.[46]

The most common methodology adopted by the courts when valuing interests in professional practices is the capitlisation of super profits methodology.[47] The capitlisation of super profits methodology is a variant of the capitlisation of earnings approach which in turn has been described as a simplification of the discounted cash flow analysis.[48] It requires an estimate of the firm's future maintainable earnings to be calculated. A notional market salary and tax is then deducted from this figure.[49] The balance is then described as excess or super profits. A multiple is then determined based on the unique circumstances and risk profile of the firm and applied to this super profit figure to calculate the final value to be attributed to the professional practice.[50] The super profits method is particularly common when valuing professional practice interests because unlike other commercial businesses, professional practices such as law firms rely heavily on the equity partners to generate the firms profits and therefore the valuation method needs to take into account this reliance.[51]

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[43] James R Hitchner *Financial Valuation: Application and Models* (3rd ed, John Wiley and Sons, Hoboken (New Jersey), 2011) at 143.
[44] Lyne and von Keisenberg, above n 41, at 37-38. Lyne and von Keisenberg state that the future maintainable earnings can be expressed as earnings before interest, tax, depreciation and allowances (EBITDA), earnings before interest and tax (EBIT), profit before tax (PBT) or profit after tax (PAT). They state that when calculating this figure it may also be necessary to "normalise" those earnings for factors such as non-work related expenditure, shareholder and director salaries above or below market rates and abnormal or unusual items which may have occurred in the past but which would not be expected to impact on future earnings.
[45] Peart, above n 30, at [MP2.01.08(2)].
[46] Lyne and von Keisenberg, above n 41, at 37-38.
[47] See discussion in chapter two.
[48] *Scott v Williams*, above n 6, at [109].
[49] *Scott v Williams*, above n 6, at [67].
[50] *Scott v Williams*, above n 6, at [67] state that this final figure will also be adjusted for work in progress and partner current accounts. Lyne and von Keisenberg, above n 41, at 39 also add surplus assets and deduct debt to this figure to find the total enterprise value. This step is not apparent in *M v B* [2006] 3 NZLR 660 (CA).
[51] Geoff Adlam "What is needed to value a law practice?" *Lawtalk 908* (online ed, New Zealand, 30 June 2017) at 60-61.

Asset-based valuations will be appropriate where the business value is substantially represented by the value of an underlying asset.[52] Finally, comparative valuations are the use of comparative sale and purchase transactions to calculate the value of a business.

1.4.3 Date at which property should be valued

The date at which property is valued can have a significant impact on the valuation. Section 2G(1) of the PRA sets out the general rule that the value of any property is to be determined as at the date of the hearing of the application by the Court of first instance. However, the Court of first instance or a Court on appeal may in its discretion decide that the value of the property is to be determined at another date.[53]

1.5 Valuation standards in New Zealand

There is scarce written codification of valuation standards that must be followed in New Zealand.[54] However, the Council of the Institute of Chartered Accountants of New Zealand issued the Advisory Engagement Standard 2 on Independent Business Valuation Engagements in order to "establish standards and to provide guidance on the performance of an independent business valuation engagement."[55] These standards are useful to detail in order to understand recognised business valuation approaches, valuation methodologies, and the factors commonly identified and relied upon when carrying out independent business valuations.

Under the standard, when planning a valuation of a business, a member should obtain sufficient understanding of the relevant industry in which the business operates.[56] This may include critical success factors, competitors and respective market shares, industry regulations, new developments, environmental issues, trading volumes and price ranges of publicly traded shares, comparable market transactions, and sufficient information relating to the general economic conditions affecting the underlying business operations.[57]

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[52] Lyne and von Keisenberg, above n 41, at 35.
[53] Property (Relationships) Act, s 2 G(2).
[54] Lyne and von Keisenberg, above n 41, at 30.
[55] Institute of Chartered Accountants of New Zealand *Advisory Engagement Standard 2: Independent Business Valuation Engagements* (AES 2, April 2002). The Institute of Chartered Accountants of New Zealand is now known as the Institute of Chartered Accountants Australia and New Zealand.
[56] At [18].
[57] At [18].

In performing the independent business valuation, the member must determine the appropriate business valuation approach to be employed. This includes the fair or fair market standards of value and the going concern or liquidation bases.[58] The member must also select the appropriate valuation methodology which may include discounted cash flows, capitalisation of earnings, capitalisation of dividends, asset realisation, market comparison-based techniques, or other recognised industry-specific valuation approaches and benchmarks.[59]

1.6 Evidence of value

When determining the value of relationship property under the PRA, a court will often rely on the evidence through the use of expert valuers appointed by each party. The valuation of relationship property, particularly professional practice interests, requires significant skill and experience.[60] The role of the expert is to:[61]

> educate or inform the Court about the relevant aspects of the witness's speciality to enable the court itself to assess the evidence, which, without that tuition, the Court would be unable to do.

The calling of expert evidence in court proceedings is governed by the rules found under the Evidence Act 2006 and the relevant court rules.[62] For the purposes of this dissertation it is not necessary to examine these rules further than simply mentioning a few important points.

Pursuant to s 25 of the Evidence Act 2006 the requirements to admit evidence are that the opinion is of an expert, that it is expert evidence and that it offers substantial help to the fact finder. Expert is defined as "a person who has specialised knowledge or skill based on training, study, or experience" and expert evidence is defined as "the evidence of an expert based on the specialised knowledge or skill of that expert and includes evidence given in the form of an opinion."[63]

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[58] At [27].
[59] At [29]-[30].
[60] Lyne and von Keisenberg, above n 41, at 91.
[61] Justice Chesterman RFD "The Accountant as Expert Witness" (paper presented to the Institute of Chartered Accountants conference, Sydney, March 2000). See also Katherine Lellman and Her Hon Judge MacKenzie "Evidence for Family Lawyers" (New Zealand Law Society Seminar, June 2011).
[62] Law Commission, above n 1, at 273. See also High Court Rules 2016, r 9.36-9.46; District Court Rules 2014, r 9.27-9.37; and Family Court Rules 2002.
[63] Evidence Act 2006, s 4.

Experts have an overriding duty to assist the court and provide sufficient information to perform its role as fact-finder.[64] Schedule 4 of the High Court Rules 2016 sets out the Code of Conduct for expert witnesses.[65]

The court can also manage how expert evidence is presented. The court can direct experts to convene at a conference prior to the hearing to reach agreement on certain matters and prepare joint statements for the matters on which they disagree.

The High Court may also require experts to give evidence at the same time and in each other's presence.[66] Such an approach allows the Judge to ask the same questions of the experts at the same time and facilitate debate over differing opinions between them.[67] Whilst partners to the relationship often employ multiple experts to give evidence in support of their position the court can also appoint its own expert under s 38 of the PRA.[68]

[64] High Court Rules, r 9.43; and District Court Rules, r 9.34.
[65] See also *K v K* (2004) 23 FRNZ 534 at [78]-[79] where the High Court confirmed that the obligations in Schedule 4 applied to experts in the Family Court.
[66] High Court Rules, r 9.46. This approach is known colloquially as hot-tubbing.
[67] Jefferson and Moriarty, above n 16, at 246.
[68] High Court Rules, r 9.36; and District Court Rules, r 9.27.

CHAPTER TWO: VALUATION OF PROFESSIONAL PRACTICE INTERESTS – THE STATUS QUO

2.1 Introduction

Now that the general principles and approach to the valuation of relationship property under the PRA have been laid out, chapter two will seek to expound the current law as developed by the courts. There are a number of cases which have come before the New Zealand courts that have dealt with the valuation of professional practices, an examination of which follows.

2.2 Classifying professional practice interests as property under the PRA

Property is defined under s 2 of the PRA. The Court of Appeal in *Z v Z (No 2)* held that this definition did not encompass earning capacity.[69] The Court reflected that whilst the definition is non-exhaustive, it generally reflects "a conventional understanding of 'property'" and to extend this to earning capacity "would be a radical departure from the conventional concept which Parliament chose to endorse."[70] During a 28-year marriage Mr Z had a prosperous career in accountancy and at the time of separation had a partnership interest in a successful accounting firm and a salary in excess of $300,000 p.a.. Conversely, early in the marriage Mrs Z had left the work force to care for their three children and now relied on a social security benefit of $7000 p.a. due to an illness affecting her ability to return to work. Mrs Z argued that her enhancement of Mr Z's earning capacity through her contributions to the marriage meant it was property capable of being valued and divided between them.[71] Whilst the Court rejected this argument they gave Mrs Z a lifeline, concluding that Mr Z's partnership interest in a professional accounting firm and the "bundle of rights" attached to it was property.[72] The Court recognised doing so was in effect treating a portion of the husband's enhanced earning capacity as property.[73] However, what was key was that this earning capacity was harnessed through an

[69] *Z v Z (No 2)* [1997] 2 NZLR 258 at 262.
[70] At 279-281.
[71] At 273. See also Bill Atkin "What kind of property is relationship property" (2016) 47 VUWLR 345 at 352-354.
[72] At 282.
[73] At 282.

external mechanism, in this case the partnership deed.[74] It is the right or interest which is property and not the "underlying concept of earning capacity" the Court explained.[75]

Therefore, if considered relationship property under s 8 of the PRA, an interest in a professional practice firm will be subject to the equal sharing regime. Subsequently this decision produced a raft of new issues concerning the valuation of these interests under the PRA.

2.3 Restraint of trade assumption

In *Z v Z* it was established that when valuing relationship property, value is to be determined on the assumption that an appropriate restraint of trade will be available.[76] This is likely to be material to the calculation of future maintainable earnings and the assignment of an appropriate multiple or discount under a valuation methodology.[77]

2.4 Terms of the partnership interest

In *Z v Z (No 2)* the Court of Appeal referred to Mr Z's partnership interest as containing a bundle of rights and stated that it is the bundle of rights derived from the partnership agreement or deed which is to be valued.[78] Included in Mr Z's bundle of rights was a retirement benefit, profit sharing and the seniority the partnership provides which were able to be valued and divided. That his rights were not assignable to anyone else and that there was no market for them did not mean they held no value.[79] Furthermore, the fact the partnership agreement stated that the partner's interest in the goodwill of the firm had no value was not determinative of actual value.[80] This is illustrative that the courts will consider not only value in exchange.

2.5 The capitlisation of super profits methodology

2.5.1 Super profits

[74] At 282.
[75] At 282.
[76] *Z v Z* [1989] 3 NZLR 413 (CA) at 416 per Richardson J, at 417 per Casey J and at 418 per Bisson J.
[77] *Scott v Williams*, above n 6, at 415.
[78] At 262.
[79] At 289.
[80] At 289.

The Court of Appeal in *Z v Z (No 2)* states a starting point to valuing the bundle of rights derived from the partnership is to ascertain whether the share of the profits the husband received from the partnership would include an element derived from his membership of the firm as distinct from his own earning capacity.[81] In other words whether the husband's earnings from the partnership would exceed the earnings appropriate as remuneration for his skill because of factors such as the income stream and client base that came with the partnership interest in the firm. The Court referred to these excess earnings as "super profits."[82] The issue of calculation was however remitted to the High Court in light of the lack of evidence.[83]

The capitalisation of super profits methodology was subsequently adopted by the Court of Appeal in *M v B* where the husband held a partnership interest in a large Auckland law firm. The parties agreed that the husband's interest in that law firm was relationship property and should be valued in terms of the guidelines outlined by the court in *Z v Z (No 2)*.[84] The value of the super profits was to be ascertained by considering the profits the husband derived from his interest in the partnership that were in excess of earnings that he could reasonably command for his skill and responsibilities.[85]

Since *M v B*, the Supreme Court noted that the capitalisation of super profits approach has become increasingly used for the valuation of professional practices.[86] The Court of Appeal in *M v B* however warned about the capitalisation of super profits guidance becoming "virtually a template" stating "as is often the case in other fields, valuations may be made by more than one method to verify the outcome."[87] The Court emphasised that it will not necessarily be the best approach in all circumstances when valuing an interest in a professional practice.[88] These sentiments were reflected by the Supreme Court in *Scott v Williams*.[89] However, the adoption of alternative methodology by the courts has yet to be seen.

[81] At 292.
[82] Law Commission, above n 1, at 217.
[83] Whilst the issue of valuation was remitted to the High Court it was settled out of court.
[84] At [51].
[85] At [168]. See also *Z v Z (No 2)*, above n 69, at 292-294.
[86] *Scott v Williams*, above n 6, at [107].
[87] At [53].
[88] At [53].
[89] At [105].

2.5.2 The multiplier and the factors that influence it

When using the capitalisation of super profits approach a multiple to be applied to the super profits must be determined.[90]

In *M v B*, the Court of Appeal emphasised a number of relevant factors when determining a multiple of three was appropriate in the valuation of the husbands partnership interest. These factors included: the age of the husband, the lack of any residual right to a capital pay out on cessation as a partner, the heavy reliance of the firm on Crown work (notwithstanding the secure income stream, the work generated fees at a lower level of remuneration than other firms), and the degree of capture by the firm (the restricted nature of the firms work reduced the ease of partners to find other work beyond the firm).[91]

In *Scott v Williams* the parties disagreed on the appropriate multiple to be applied to the super profit to value Mr Williams' interest in a small, albeit very successful, two partner law firm. The majority held that the appropriate multiple to be applied here was three, as used by the Family Court, rather than the multiple of two applied by the High Court and Court of Appeal. The main factor influencing the judgment of Glazebrook J was the low risk of diminution in earnings for a purchaser, on the basis that the goodwill was firm goodwill and not personal and thus could be transferred upon sale.[92] Other factors that influenced the determination of the multiple were that the risk of a competitor setting up in the area was not significant and the ample time to rectify the lack of retirement plan in order to maximise the value of firm goodwill upon the eventual sale of the firm.[93] A multiple of three valued Mr Williams' interest in the firm at $450,000 to be divided equally.

However, the minority would not have disturbed the Court of Appeal valuation of $300,000, adopting a multiple of two. William Young J considered that if the partnership dissolved, perhaps because of a breakdown in health of one of the partners, much of the value would dissipate.[94] He also states other factors such as age and the lack of a retirement plan meant the ability to realise value was time bound.[95] Ultimately he thought the risk of diminution in

[90] See discussion in chapter two at 1.4.2.
[91] *M v B*, above n 54, at [93].
[92] At [139].
[93] At [140].
[94] At [439]-[440].
[95] At [439]-[440].

earnings associated with the partners departure was material due to the loss of personal goodwill and that the Family Court was wrong to leave out of consideration the personal goodwill of the partners.[96]

2.5.3 Personal goodwill vs. business goodwill

In *Briggs v Briggs*, when valuing shares in a financial services company, the Court confirmed the exclusion personal skills and attributes from the valuation of goodwill for relationship property purposes.[97] In other words personal goodwill, as distinct from business goodwill, should not form part of the valuation assessment of a business. Thorp J quoted the May 1995 edition of *Canada Valuation Service* which states that:[98]

> Personal goodwill is related to the business skills of an entrepreneur, personal contacts built up by individuals in a certain environment, reputations of those engaged in business or in professional undertakings, and so on. Personal goodwill may give rise to so-called "excess profits" (or generate a rate of return in excess of that required on net tangible assets), but not be of a transferable nature or possess a market value. To have commercial value, goodwill must be transferable.

One issue facing the Supreme Court in *Scott v Williams* was whether *Briggs v Briggs* should continue to be followed in the context of valuing a professional practice interest.[99] William Young J concluded that personal goodwill was considered earning capacity and therefore not property divisible under the PRA. As discussed above, this was a pivotal factor in his adoption of a multiple of two as opposed to three. He supported his argument with reference to both *Newman v Newman* and *D v C*, two cases where it was held that no goodwill could be attributed to the value of an orthopaedic surgeons practice because the respondents income was derived solely from the utility of his personal skills.[100] William Young J also noted that when valuing the benefits derived from the partnership agreement in *Z v Z (No 2*, the Court of Appeal

[96] At [440].
[97] *Briggs v Briggs* (1996) 14 FRNZ 404 (HC). See also Fisher, above n 20, at 10.16.
[98] At 412.
[99] Whilst *Briggs v Briggs*, above n 97, was mentioned by the Supreme Court in *Thompson v Thompson* [2015] NZSC 26, [2015] 1 NZLR 593 at 33 this was in the context of restraint of trade. The approach to goodwill when valuing a business was not directly in issue.
[100] *Newman v Newman* (1999) 18 FRNZ 413 (HC) at 417-418; and *D v C* [2000] NZFLR 514 (HC) at [25] – [30].

explicitly states that the decision in no way blurred the distinction between business goodwill and personal goodwill drawn in *Briggs v Briggs*.[101]

On the other hand Glazebrook J left the issue open, commenting that excluding personal goodwill from a valuation of a professional firm may well be inappropriate in the context of the PRA given the other relationship partner would have supported the attainment of this personal goodwill through their role in the marriage.[102] This approach does not follow *Briggs v Briggs*. As discussed above, her conclusion that the goodwill present was that of the firm and not personal was pivotal to her adoption of the multiple of three.

It should be noted that whilst this dissertation will consider the distinction between personal and business goodwill and the effect of that distinction on the multiple adopted in the capitalisation of super profits methodology, it is outside of the scope of this dissertation to consider whether earning capacity should be considered relationship property.

2.5.4 Reality checks

It is clear from the case law that the court will retain a certain amount of discretion with regard to reliance on expert valuation evidence to ensure the valuation is not artificial and achieves a just and fair division. In *M v B* it was stated that:[103]

> Any approach which is adopted must include clear and unambiguous reality checks. Justice between parties will not be achieved in circumstances in which formulaic approaches lead to outcomes which are manifestly unsustainable.

Furthermore, Glazebrook J commented in *Scott v Williams* that any valuation must be subjected to a reality check if all that means is that there should not be slavish reliance on the results of any particular valuation methodology. She however states that any such reality check must not "be an arbitrary assessment by the judge but must be based on an evaluation of the evidence."[104] This discretion to subject the valuation to a reality check is relatively unfettered.

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[101] At [420].
[102] At [102].
[103] At [55].
[104] At [108].

2.5.5 Comparative sales and multiples

The use of comparative sale transactions is common place in business valuation. In *Scott v Williams* the use of comparative sales when valuing Mr Williams' interest was accepted, however because of the thin market for professional firms it was emphasised that any market transactions must be used with caution.[105]

Similarly, the comparison of multiples from previous cases was said to be useful to save time and expense.[106] However, Glazebrook J emphasised that caution must be used given the multiple is related to the particular business and evidence called in the particular case.[107] Glazebrook J concluded comparisons to the multiple used in *M v B* were unhelpful given the differences between the firms and related risk profiles.[108]

2.6 Summary

Overall, the courts have grappled with the issues that arise when spouses or de facto partners separate and a professional practice interest forms part of the relationship property pool. The approach to valuing such interests developed by the courts contains a number of principles and assumptions, most notably that value is to be determined on the assumption that an appropriate restraint of trade is available and that it is the bundle of rights which attaches to the interest that is to be valued. What is clear is that valuation methodology most commonly adopted by experts and the courts is the capitalisation of super profits methodology which involves a number of subjective assessments to be made by the court.

[105] At [106].
[106] At [138].
[107] At [138].
[108] At [116]-[119]. The firm in *Scott v Williams*, above n 6, had two partners and for the main part provided general conveyancing services for a large number of clients within the suburban area. By contrast, the firm in *M v B*, above n 50, had a far greater number of partners and relied on the Crown warrant for most of its income.

CHAPTER 3: THE ISSUES WITH THE CURRENT APPROACH

3.1 Introduction

The Law Commission recently commented that whilst there is no way of determining the proportion of relationship property matters involving valuation disputes, due to a large proportion of cases being settled privately out of court, research and consultation suggests that valuation disputes are relatively common in relationship property matters.[109] This means the valuation of professional practice interests potentially affects a large number of New Zealanders and therefore justifies an in depth examination of any issues with the current approach.

As chapter two sought to lay bare all the nuances of the current approach to the valuation of professional practice interests, this chapter will seek to explain the issues that arise from this approach and illustrate why such issues are not tolerable within the scheme of the PRA.

3.2 Contradictions with s 1N(d) PRA

It is often said that the valuation of property is more of an art than a science.[110] Such is true for the valuation of professional practices where it is never just an exercise in mathematics because no two set of circumstances are the same. For example, the valuation of an interest in a 'Big Four' accounting firm will require a significantly different approach to the valuation of a rural two-person accounting partnership because of the dissimilarities between the firms, the bundle of rights the interests provide and their risk profiles. Thus, whilst the valuation of relationship property items such as household chattels and motor vehicles are usually straightforward, the valuation of professional partnership interests and the distinct characteristics that each interest includes make them inherently more complex to value. Furthermore, given one party usually desires to retain or is unable to sell a professional practice interest, partners will often disagree on the appropriate valuation and in turn the sum they should receive for their equal share of the interest.[111] These valuation disagreements contribute costs and delays to the resolution of

[109] Law Commission, above n 1, at 275.
[110] Griffiths, above n 20, at 98.
[111] Law Commission, above n 1, at 275.

relationship property matters not only through counsel and court costs but also because valuation evidence is usually adduced through the costly use of experts in court.[112]

For reasons that will be explored in this chapter the current approach to valuing professional practice interests lends itself to delayed, costly and complex disputes which directly contradict the principle that questions arising under the PRA about relationship property should be resolved as inexpensively, simply and speedily as is consistent with justice.[113]

This issue was examined by William Young P (as he then was) in *M v B* where he commented that the costs associated with the dispute over the valuation of a professional practice interest were disproportionately high in respect of what was at stake.[114] He states that insisting on valuation methodologies, in this case the capitlisation of super profits, which commit disputing parties to costs that are disproportionate to what is being valued, are inconsistent with the principle under s 1N(d) of the PRA.[115]

Requiring parties to commit to such time and expense cannot be said to produce an outcome that is fair and just in line with the purpose of the PRA.[116] This is the overarching issue which forms the basis of this chapter.

3.3 The capitlisation of super profits methodology

In theory the capitalisation of super profits methodology is a simple calculation. However, the practicalities of the calculation are more complex. When speaking with Brendan Lyne of Lyne Davis Opinion, he explained that the assessment of future maintainable earnings is relatively straightforward if the appropriate evidence from financial statements is available.[117] Where this methodology becomes complex is through the analysis of a hypothetical notional income attributed to a person's skill and industry and the assignment of an appropriate multiple which

[112] See *Scott v Williams* [2014] NZFC 4347 where the costs Ms Scott claimed were exorbitant illustrating the expensive nature of the exercise.
[113] Property Relationships Act, s 1N(d).
[114] At [167].
[115] At [167].
[116] See Property Relationships Act, s 1M(c).
[117] Interview with Brendan Lyne, Accountant (the author, telephone conversation, 21 August 2018). Brendan Lyne (BCom, MBA (distn), MBS (Finance), AAMINZ, CA, CMA, CSAP) is a director and principal of Lyne Davis Opinion with more than 30 years' accounting and corporate finance experience.

reflects all the factors and contingencies that effect the value of the professional practice interest and the bundle of rights derived from that interest.[118] Reflecting sentiments of the overarching issue described above, the Law Commission has expressed concern as to whether the costs and depth of analysis can be justified where the professional practice interest is relatively modest.[119] Furthermore the outcome of this valuation methodology is relatively uncertain and unpredictable with the different courts often oscillating between different valuations at each stage of the litigation.[120] Ensuring that the costs of litigating a valuation dispute in court is proportionate with the potential financial reward has become a game of Russian roulette for litigants in this area.

3.3.1 The complexity of determining a hypothetical notional salary

In *Z v Z (No 2)* the Court of Appeal suggested that an approach to the assessment of super-profit, in respect of an accountant's interest in his firm, would be to determine whether the accountant's remuneration derived from the professional practice was higher than they would reasonably be able to be command for their skill and responsibilities.[121] The capitlisation of super profits therefore involves establishing a notional salary that one could command for their skills in their industry as separate from the additional earnings generated by the firm's goodwill. This is a sophisticated and complex analysis. As the Law Commission comments most people are unlikely to distinguish between the income attributable to the earning capacity of an individual as against the excess income derived from a partnership interest.[122] Furthermore, such analysis would require significant evidence that illustrates the distinction between the two, the availability of which is likely to be scarce.[123]

Such complexities were seen in *M v B*. In the High Court Allan J decided the best way to determine an appropriate salary for the husband, in order to determine the value of any super profits, was to compare the husband's salary with the salary he could command as a barrister

[118] Law Commission, above n 1, at 220.
[119] Law Commission, above n 1, at 220.
[120] See *Scott and Williams*, above n 6. A valuation of $450,000 using a multiple of 3 was decided at the Family Court and Supreme Court whilst a valuation of $300,000 using a multiple of 2 was decided in the High Court and Court of Appeal.
[121] At 294.
[122] Law Commission, above n 1, at 219.
[123] Mark Henaghan and others *Family Law in New Zealand* (18th ed, Lexis Nexis, Wellington, 2017) at 1050.

at the independent bar.[124] The Court of Appeal when commenting on the High Court's approach noted that when assessing the salary the husband could command at the independent bar, the expert accountants relied upon base material from others and had no particular knowledge or experience as to what a person with the husband's skill, experience and attributes would be capable of earning inside or outside the firm.[125] On this question Allan J was also confronted with multiple sources of lengthy, complex and conflicting evidence, including that from a Queens Counsel and former salaried member of the husband's law firm now a successful barrister.[126] This highlights the evidentiary burden faced by the courts.

The unsatisfactory outcome of appropriate salary to be assigned to the husband in High Court meant the issue was further argued in the Court of Appeal.[127] Robertson J commented that the process of determining an appropriate salary for a 'clone' arrangement needed to have proper regard to the multifunctional nature of the partner's task, the actual work undertaken, as well as what he could reasonably have achieved outside the firm.[128] Such an exercise requires significant evidence detailing work and responsibilities, experience, skill and hours of work and the difficult task of the Judge arriving at a figure that appreciates all these factors. One commentator remarked that the Courts approach in *M v B* meant valuations would now depend even more on the subjective judgement from both expert valuers and Judges of the fair reward for the individual partner concerned, enlarging the scope for disagreement.[129]

William Young P, reflecting on the concerns of the capitlisation of super profits methodology, commented that the relevant super profit figure adopted should have been based on an appropriate remuneration figure for a partner in the firm, rather than on an earnings capacity assessment which was so specific to the husband.[130] He commented that the Court in *Z v Z (No*

[124] At [64]. See also *Z v Z (No 2)*, above n 69, at 292 where the Court of Appeal suggested a notional salary might be derived by determining what is reasonably able to be commanded by a person for their skill and responsibilities or identifying the cost of replacing the holder of the professional practice interests with the employment of a suitably qualified person. The court noted as instructive the New Jersey case of *Dugan v Dugan* (1983) 457 A 2d 1(NJ) which, although directed to the valuation of goodwill, ascertained what an attorney of comparable experience, expertise, education and age would be earning as an employee in the same general locale.
[125] At [65].
[126] At [65]-[66].
[127] Allan J in *B v M* [2005] NZFLR 730, (2004) 24 FRNZ 610 concluded at the High Court that there was no super profit because the comparative figure for a clone of the husband at the independent bar was not significantly different from the income the husband could anticipate from the firm.
[128] *M v B*, above n 50, at [82].
[129] David Hicks "More just results?" (1997) 2 BFLJ 122 at 123-124.
[130] *M v B*, above n 50, at [169]. However, arriving at an appropriate remuneration figure for a partner in the firm would also be problematic and face similar difficulties.

2) could not have envisaged the sort of exercise carried out by the Court of Appeal in *M v B*, which turned so much on an assessment of the husband's skill and expertise and a "sterile debate" of potential earnings from a hypothetical career path.[131] It is clear the Court felt the exercise was unsavoury. This was further illustrated when William Young P comments that when determining a notional salary, the wife had attempted to portray the husband's position as simply a product of luck and timing degenerating the exercise into a "demeaning and undignified attack on the husband's abilities."[132] The process had invited disagreement and conflict between the parties that would likely increase the tension between them.

William Young P had further concerns that the personalised nature of the super profits valuation methodology, with the value of the partnership interest depending in part on an assessment of one's personal earning capacity, would mean that the exact same bundle of rights attached to a professional practice interest held by two different people could be assessed at different values despite having the same economic expectations from the firm.[133]

The difficulty then is whether the Court can accurately and consistently determine what income should be attributed to a partner's skills and experience or whether the exercise is simply too complex and riddled with flaws.

3.3.2 The arbitrary determination of a multiple

Deciding on an appropriate multiple when using the capitalisation of super profits method is a difficult and subjective task. Commentators have described the process of determining the appropriate multiple as "arbitrary",[134] a claim refuted by the Supreme Court in *Scott v Williams* who state an expert must always carefully explain all of their inputs in arriving at the multiple.[135]

The complexity of the process was illustrated by the Law Commission when commenting on all the factors that the multiplier must reflect:[136]

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[131] At [168].
[132] At [167].
[133] At [167].
[134] Nicola Peart (ed), above n 30, at [PR2G.07(5)).
[135] At [112].
[136] Law Commission, above n 1, at 220.

> the peculiarities of, among other things, the nature of the firm's business, the specific terms of the partnership deed, and contingencies relating to the individual partner concerned, such as proximity to retirement or other factors affecting work output.

The factors emphasised by the Court of Appeal in *M v B* (including age, the value of any retirement benefit, security of work and income, and the degree of capture by the firm) provide a useful starting point for experts when valuing professional practice interests and give some certainty as to what the courts will consider when determining an appropriate multiple.[137] However, despite this there was still considerable disagreement in *Scott v Williams* over the appropriate multiple to be adopted. Whilst largely the same factors were considered by the majority and the minority there was significant disagreement as to whether these factors, or risks, were present in the circumstances despite all having the same expert evidence before them. This was most obviously seen in the difference of opinion between Glazebrook J and William Young J regarding the risk of future diminution in earnings if one or both of the partners left the firm.[138]This illustrates that the scope for disagreement and wide discretion granted to judges makes determining an appropriate multiple a capricious process. Inevitably elements of discretion and subjectivity in the valuation of relationship property, particularly professional practice interests, is necessary to achieve a result that is just and fair given the unique circumstances of each case. However, too much open ended discretion invites arbitrariness, disagreement and uncertainty into the valuation process.

3.3.3 The difficult distinction between personal goodwill and business goodwill

The distinction between personal and business goodwill is important to the valuation of professional practice interests because whilst business goodwill is transferable and therefore possesses a market value, personal goodwill is not and therefore possesses no market value.[139]The issue, as highlighted by Glazebrook J in *Scott v Williams*, is the significant difficulty in distinguishing between personal and firm goodwill.[140]

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[137] Tony Weber "The value of business" *NZLawyer* (New Zealand, 9 September 2011) at 22-23.
[138] See discussion in chapter two at 2.5.3.
[139] Fisher, above n 20, at 10.16. See also discussion in chapter two at 2.5.3.
[140] At [104].

This difficulty is not novel and was expressed in *Briggs* when Thorp J stated that it is "an extraordinarily difficult exercise trying to determine how much of a business is tied to its operator and how much is transferable."[141] Similarly in *Grounds v Grounds*, whilst it was clear that the particular business relied in part upon the personal qualifications of the vendor and thus personal goodwill existed, the assessment of how much of the goodwill was personal was less straightforward.[142] In assigning 70 percent of the value of goodwill as personal or non-transferable, Judge A J Twaddle concluded that such a distinction "is an imprecise process to be approached broadly as a matter of judgment."[143]

The difficulties of the subjective distinction can be further illustrated through the differing opinion of the majority and minority in *Scott v Williams*. The presence of personal goodwill and the associated risk of a diminution in earnings should one or both of the partners leave the firm was a factor considered by both the majority and minority in *Scott v Williams* when determining the multiple to be adopted for the capitlisation of super profits methodology.[144] Glazebrook J concluded that any goodwill involved in the law firm was largely that of the firm and not personal to the two partners.[145] This view was reinforced by the fact that during the previous year Mr. Williams was absent from the firm due to illness for 8 months which had seemingly no impact on the earnings of the firm.[146] By contrast the experts called by Mr. Williams were unsurprisingly of the view that there was significant personal goodwill associated with the firm. This view was shared by William Young J who noted that it was important to recognise that during the period of 8 months, from which Mr. Williams was absent from the firm, he remained a partner of the firm and thus he didn't believe it could be assumed there would be no loss in profitability if Mr. Williams left the firm.[147]

The difficulties, disagreement and uncertainty surrounding how the courts will make the distinction between personal and business goodwill is a cause for concern. This is particularly so because the distinction, and its effect on the multiple adopted, is significant to the outcome of the valuation.

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[141] *Briggs v Briggs*, above n 97, at 413.
[142] *Grounds v Grounds* [1997] 2 NZLR 258.
[143] At 459.
[144] The majority and minority however had different conclusions about whether personal goodwill existed and what effect it had on the multiplier. See discussion in chapter two at 2.5.3.
[145] At [123].
[146] At [123].
[147] At [433].

3.4 Disagreements in expert evidence

Disagreement between expert valuers on the valuation of a professional practice interest can add vast expense and delay to the settling of relationship property matters. Despite this, it must be remembered that there is always scope for disagreement between experts due to their valuation being an opinion that is based on fact. Valuers can legitimately hold differences in opinion due to differing opinions on key variables and assumptions used in the valuation.[148] As the Court in *Holt v Holt* noted in the context of valuing company shares, if the shares had been submitted to five different valuers it would not be unlikely that five different values would be produced.[149]

However, when one examines the use of expert valuers in relationship property litigation it is clear, and for obvious reason, that the valuers called by each party will always be those that supports the position of the party who is instructing them. This can often cause significant differences in valuations. For example, in *M v B* both the husband and wife engaged expert valuers who were given the same instructions, to value the husbands interest in a large law firm. The valuer engaged by the wife adduced a value of $1,341,000 for the law firm whereas the valuer for the husband adduced a value of $182,000. Such significant differences between the valuation given for a professional practice interests is concerning particularly with regard to the time and expense it is likely to add to relationship property disputes. Significant disagreements, beyond differing opinions and judgements on key variables and assumptions involved in the valuation process, can be caused by a variety of reasons.

3.4.1 Provision of information

Obtaining information to accurately undertake a valuation is often difficult and can lead to disagreement between experts on the outcome of a valuation.[150] When difficulties arise in obtaining information to form a valuation opinion, both time and cost can be extensively inflated especially when interlocutory proceedings are necessary in the pursuit of discovery.

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[148] See Lyne and von Keisenberg, above n 41, at 91 where Brendan Lyne comments that it is not uncommon for valuers to have significant differences in the quantum of their valuation of businesses.
[149] *Holt v Holt*, above n 23, at 95.
[150] Interview with Brendan Lyne, Accountant (the author, telephone conversation, 21 August 2018). See also Lyne and von Keisenberg, above n 41, at 86.

This issue is made more complex by the fact that relationship property litigation often has a very strong emotional dimension and one partner of the relationship usually controls the provision of necessary information.[151]

Difficulties faced in obtaining information can be particularly detrimental when valuing professional practice interests given such significant amounts of information are needed to form an opinion. Taking the valuation of a law firm as an example, Geoff Adlam lists in his article "What is needed to value a law practice?" the substantial amount of information necessary to undertake a valuation of a law practice as including:[152]

(a) copies of the firm's financial statements for the last three financial years;
(b) a copy of the firm's current year to date management accounts and budget;
(c) a copy of fees by author reports produced from the firm's practice management system;
(d) general detail of gross fees by type of legal work;
(e) a list of the top 20 client fees by client group, and type of work undertaken – this is to assess risk or reliance on single large clients and to assist with making an assessment regarding transferability of work; and
(f) a list of equity partners and their ages, non-equity partners and legal authors.

Furthermore, to avoid disagreement between valuations of professional practice interests it is desirable that all experts on both sides are provided with the same information and have access to the key parties that operate the business to ensure an accurate opinion is reached.[153] However, Brendan Lyne explained that unfortunately this is not always possible.[154] As such, this is a contributing factor to the increased cost and delay of valuation disputes.

3.4.2 Bias

Disagreement in expert valuers' evidence can also be a result of bias. Evan Bell notes one of the central difficulties faced by the Court in modern litigation when discharging their

[151] Lyne and von Keisenberg, above n 41, at 86.
[152] Geoff Adlam "What is needed to value a law practice?" *Lawtalk 908* (online ed, New Zealand, 30 June 2017) at 60.

[153] Lyne and von Keisenberg, above n 41, at 91.
[154] Interview with Brendan Lyne, Accountant (the author, telephone conversation, 21 August 2018).

responsibility to evaluate expert evidence and determine its probative value is the need to consider the objectivity of the evidence.[155] When parties select and instruct their own experts there is a risk of selection bias in that parties will shop around for an expert that will give evidence that supports their position, muddying the lines between the objective, informative role of the expert and the adversarial nature of litigation.[156] Experts that allow, even unwillingly, their opinion to be affected by bias in favour of the party who is paying them can cause disagreement between valuations which in turn can cause delay and expense to the parties.

3.5 Summary

A critical analysis of the current approach to the valuation of professional practice interests reveals a number of issues. As stated the overarching issue permeating the current approach is its contradiction with the principle under s 1N(d) of the PRA. The complexity, scope for disagreement and uncertainty created by the use of the capitlisation of super profits methodology, particularly in the determination of a hypothetical notional salary and appropriate multiple, adds costs and delays to relationship property litigation. Imposing exorbitant costs on parties to resolve such issues through litigation can hardly be said to be ensuring a just and fair division of relationship property in line with the legislative purpose of the PRA. Furthermore, the scope for disagreement between expert valuation opinions is widened by the difficulties in obtaining sufficient information to undertake a valuation and the selection bias that can be present when parties shop around for experts to support embellished positions.

[155] Evan Bell "Judicial Assessment of Expert Evidence" (2010) 2 IJSJ 55 at 55.
[156] Jefferson and Moriarty, above n 16, at 12.

CHAPTER 4: EXPLORING OPTIONS FOR POTENTIAL REFORM

4.1 Introduction

In the final chapter of this critical analysis I will explore and recommend potential options for reform that will address the issues highlighted in chapter three to ensure that the approach is more consistent with the stated legislative purpose and principles under the PRA.

4.2 Achieving the right mix of rules and discretion within the capitlisation of super profits methodology

When reviewing the current approach to the valuation of property under the PRA, the Law Commission commented that "the main option for reform we can see is to introduce rules into the PRA that prescribe in greater detail how property should be valued."[157]

Similarly, in *M v B*, William Young P called for a simpler and cheaper methodology to the valuation of professional practice interests, involving rules of thumb or conventional approaches that broadly capture the underlying valuation principles.[158] When speaking of his desire for simpler and cheaper methodologies, William Young P saw as instructive both the approach of the Court of Appeal in *Haldane v Haldane* in relation to the valuation of superannuation entitlements and the use of the Ogden Tables in personal injury claims in England in order to avoid the high costs of evidential proof in individual cases.[159] Whilst William Young P accepted that the valuation of professional practice interests was more difficult in comparison to the valuation of superannuation entitlements and personal injury claims (and thus less amenable to rules and rules of thumb) he saw these examples as instructive of a desired approach to the valuation of professional practice interests.[160]

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[157] Law Commission, above n 1, at 277.
[158] At [167].
[159] At [170]. See also Government Actuary's Department, *Actuarial Tables with explanatory notes for use in Personal Injury and Fatal Accident Cases* (7th ed, The Stationary Office, London, 2011). The Ogden tables are actuarial tables that assist lawyers and judges in the computation of damages for loss of earning capacity in personal injury cases. The calculation of these lump sum damages is done by the application of multipliers to the present value of a future annual loss or expense. These multipliers are adduced from the Ogden tables by the court.
[160] At [171].

The judges in *M v B* were however divided on this point, with Robertson J commenting that the value of property such as this will always be "a jury issue" and not a rigid arithmetic calculation.[161] This was echoed by Hammond J who states that in any valuation situation the law should prefer actualities to abstracted and somewhat hypothetical calculations, or rules of thumb, whenever that is possible. [162]

Such disagreement calls for the analysis of whether rules, discretion (including discretion guided by guidelines and checklists) or a mix of both within the law governing the valuation of professional practice interests would best ensure the just division of relationship property in accordance with the purpose and principles of the PRA.

4.2.1 Rules vs. Discretion

The capitlisation of super profits approach to the valuation of professional practice interests is largely discretionary.[163] Whether this is the best approach is arguable. However, before examining the application of potential rules or rules of thumb to the valuation of professional practice interests, it is first useful to discuss generally the use of both rules and discretion in a relationship property context. Joanna Miles of the University of Cambridge has provided a sound overview of the 'pros' and 'cons' of rules and discretion and I therefore adopt her arguments here.[164]

The use of rules or rules of thumb ensure more certainty allowing cases to be decided in an "efficient, consistent and so predictable manner."[165]In cases where a partnership interest is relatively modest, certainty as to the value of the interest would allow the parties to plan and assess whether the cost of litigating a valuation dispute is proportionate to the potential financial reward.[166] As such, this certainty can also aid settlement out of court.[167]

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[161] At [54].
[162] At [230].
[163] This is particularly so with regard to the assignment of a multiple and a notional salary under the capitlisation of super profits methodology.
[164] Joanna Miles "Should the regime be discretionary or rules-based?" in Jessica Palmer, Nicola Peart, Margaret Briggs and Mark Henaghan (eds) *Law and Policy in Modern Family Finance* (1st ed, Intersentia, Cambridge, 2017).
[165] Miles, above n 164, at 266-267.
[166] Miles, above n 164, at 266-267.
[167] Law Commission, above n 1, at 277; and Joanna Miles, above n 164, at 266-267.

The use of rules or rules of thumb would also reduce costs and delays in relationship property valuation disputes. This is because the use of rules or rules of thumb would likely be more straightforward for judges, lawyers and experts to apply reducing the time and expense required.

Therefore, given the issues with the current approach to the valuation of professional practice interests, the use of rules or rules of thumb in the determination would in theory be the most obvious option for reform.

There are however two issues with the adoption of rules or rules of thumb that stand out. First whether the rougher average justice, as opposed to individualised justice, that rules provide can be tolerated under the PRA. As the Law Commission commented "if the rules were too prescriptive and inflexible, they could jeopardise the courts ability to arrive at a value that is fair in the circumstances of each case."[168] The second issue is what form these rules or rules of thumb would take to ensure they are more straightforward, timely and cost-effective than the current approach.

4.2.2 A solely rules based approach

Based on the multitude of factors and complex analysis that make-up a valuation of a professional practice interest, a solely rules based approach will produce unfairness.[169] This assessment however does not preclude a finding that the best and most cost-effective approach is a mixture of both rules and discretion.

It is unlikely that any simple mathematical formula, such as that developed by the Court of Appeal in *Haldane*, would be sufficient to meet the variety of considerations to be taken account of when valuing a professional practice interest.[170] Furthermore, the Supreme Court has been clear in its statement that no one specific methodology should be elevated into a test

[168] Law Commission, above n 1, at 277.
[169] An example of the multitude of factors that make-up the valuation of a professional practice interest was illustrated in *M v B*, above n 50, at [93] where the court considered the age, the value of any retirement benefit, security of work and income, and the degree of capture by the firm. Similarly in *Scott v Williams,* above n 6, the experts and Supreme Court considered the nature of the law firms services, the risks of the business, the size of the partnership group, the age of the partners, the lack of compulsory retirement age, the client base, the profitability of the firm, the consistency of earnings and the economic environment.
[170] The approach adopted in *Haldane v Haldane*, above n 21, is not the only approach to valuing superannuation entitlements.

for determining the the value of professional practice interests.[171] This is because valuation methodologies should be aimed at ensuring a fair and just division of relationship property and therefore the appropriate methodology will depend on the circumstances of the case.[172] Therefore, this chapter will examine the potential application of both rules and discretion to parts of the capitlisation of super profits methodology in an attempt to find the right mix.

4.2.3 Standardising the assessment of a hypothetical notional salary

The determination of a hypothetical notional salary under the capitlisation of super profits method is particularly complex and problematic.[173] This was expressed by William Young P in *M v B* who states that the courts should encourage a less personalised approach to the assessment of super profit.[174] The depersonalisation of relationship property disputes is not a newfound idea. The Law Commission recently commented:[175]

> Separation is generally a time of emotional upheaval, and recently separated partners are often on bad terms. There are therefore good reasons why relationship property issues should be depersonalised as much as possible.

The assessment of whether the remuneration derived from a professional practice is higher than the salary reasonably able to be commanded by an individual should be determined without such a complex and personalised assessment of an individuals earning capacity.[176] Such an approach is possible by standardising the assessment through the use of a rule that requires salary averages of both salaried and equity partners (depending on which of these forms of partnership the individual falls into) obtained from industry salary surveys to be used in the assessment of a notional salary under the capitlisation of super profits method.

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[171] *Scott v Williams*, above n 6, at [105].
[172] *Scott v Williams*, above n 6, at [105]. There is little judicial guidance as to what fair and just means. One of the purposes of the PRA under s 1 M(c) is to provide for a just division of the relationship property between the spouses or partners when their relationship ends by separation or death. The Court of Appeal considered the purpose and principles of the PRA in *M v B,* above n 50. Robertson J at [34] rejected the submission that these provisions were intended by Parliament to provide an open-ended discretion to achieve equality, justness, and fairness. Hammond J at [227] commented that a just award will have regard to the principles and purpose of the legislation.
[173] See further discussion in chapter 3 at 3.3.1.
[174] At [169]. William Young J explains this suggestion of a less personalised approach further by stating that in his view the relevant super-profit figure adopted should have been based on an appropriate remuneration figure for a partner in the firm rather than on an earnings capacity assessment which was so specific to the husband.
[175] Law Commission, above n 1, at 224.
[176] See *M v B*, above n 50, at [167].

In the Family Court in *Williams v Scott*, a number of the expert valuers, when determining an appropriate comparator salary for Mr. Williams, adduced evidence from various industry-wide legal salary surveys.[177] The resources referred to include the 2011 Markham's Legal Practitioners Survey,[178] the 2008 Hays Legal Salary Guide,[179] and the University of Waikato Benchmarking Survey 2010.[180] Their use is therefore not novel. However, the experts and the Court spent considerable time departing from the quantum of these salary averages taking a personalised approach with reference to the individual circumstances of Mr. Williams including his work and responsibilities, the complexity of his work, the experience level required and his hours of work.[181]

For the purposes of this discussion I will continue to take the legal profession and the resources referred to in *Williams v Scott* as an example. The Hays Legal Salary Guide provides both an average before tax salary and average before tax salary range for lawyers at various levels in the private practice and in-house corporate legal sectors. This includes the remuneration of both salaried and equity partners. Relevant to this discussion is the private practice firms. Within the private practice section law firms are divided into three tiers labelled large law firms (greater than 20 solicitors), medium law firms (5 – 20 solicitors) and small law firms (less than 5 solicitors). Salaries are also reported by location to reflect geographic contingencies in average salaries. The survey is conducted annually is conjunction with the New Zealand Law Society. Similarly, the annual Markham's Legal Practitioners Survey provides an average before tax salary and average before tax salary range for solicitors of various levels of experience including equity and non-equity salaried partners in private practice firms. Again, law firms are divided into tiers. Markham's survey also provides the average gross fees generated per equity partner in each tier as well as the type of work undertaken by these firms. It is therefore my contention that the court can readily adduce an appropriate notional salary based on salary averages from these sources for a salaried or equity partner in a comparable law firm to be applied in the capitlisation of super profits methodology.[182]

[177] *Williams v Scott* [2014] NZFC 7616.
[178] Sam Bassett and Dennis Munn and Geoff Hatten *Auckland Legal Practitioners Survey* (Markhams, 2011).
[179] Hays *Legal Salary Guide* (2008).
[180] University of Waikato *NZ Business Benchmarking Survey* (2010).
[181] At [196].
[182] A professional practice comparable in size, type of work and gross earnings.

Furthermore, similar salary surveys exist for a number of other professional industries in New Zealand. For example, the 2018 Hays Salary Guide provides average salary information for 25 industries in New Zealand.[183] As such it is assumed that an appropriate notional salary for individuals in other professions based on salary averages of individuals with comparable partnership interests in a professional practice would be readily available to the court.[184]

This approach would significantly depersonalise the process of determining an appropriate notional salary. The use of average salary figures would ensure the undignified exercise that occurred in *M v B* did not occur again as it would no longer be available to the parties, nor necessary, when determining a notional salary, to attack the opposing party's skill and ability.[185] Furthermore, this approach limits the scope for disagreement in valuation outcomes and therefore reduces the associated costs and delays incurred when experts wrangle over the determination of a notional salary. This rule is therefore is synonymous with s 1N(d) of the PRA.

The use of averaged salary figures would also ensure that the mischief William Young P described, namely that the exact same bundle of rights attached to a professional practice interests held by two different people could be assessed at different values despite being in identical positions and having the same economic expectations from the firm, would be quashed since their earning capacity would be assessed as equal.[186]

When discussing the use of simpler and cheaper methodologies involving rules of thumb or conventional approaches to the valuation of professional practice interests William Young P commented:[187]

> While the values that are produced in this way will not be mathematically or actuarially pure, the overall outcomes (after the costs of the exercise are allowed for) are likely to be better for all concerned.

[183] Hays *Salary Guide: Salary and Recruitment Trends* (2018).
[184] For example, the salary guide provides information about the accounting and finance industry. Therefore, an average salary could be calculated for the purposes of valuing a partnership interest in an accounting firm.
[185] See *M v B*, above n 50, at [74] and [167].
[186] *M v B*, above n 50, at [167].
[187] *M v B*, above n 50, at [167].

A similar conclusion can be made for the use of salary averages. Joanna Miles comments that rules that give more or less rough average justice are tolerable where the cost of determining a more accurate answer is disproportionate for both the system and the parties.[188] Using average salary figures would not as accurately reflect all the contingencies currently considered by the courts. However, the use of average salary figures, whilst creating an outcome that may not be mathematically pure, is tolerable because of the benefits it provides. The benefits I have described are a reduction of costs and delay, tightening the scope for disagreement and demeaning conduct in litigation, and creating consistent and predictable outcomes. The discretion the court retains through the determination of an appropriate multiple to be used in the capitlisation of super profits method and the ability to subject each valuation to a reality check complement this rule by allowing the court the discretion required provide a just division of relationship property in the individual circumstances.

4.2.4 The determination of a multiple

The scope for disagreement and wide discretion granted to judges in the determination of an appropriate multiple for the capitalisation of super profits methodology has allowed disagreement and uncertainty into the valuation process.[189] Despite this assessment the introduction of rules or rules of thumb to aid the determination of the multiple is likely to produce too much unfairness. Whilst other parts of the calculation, particularly the determination of a notional salary, may be amenable to a rougher rule based approaches, the determination of a multiple is required to reflect such specific attributes and peculiarities of each individual professional practice that it requires discretion to ensure a result that is just and fair for the individuals. The use of tables such as the Ogden tables to extract multiples in an attempt to avoid disagreement and the high costs of proof is admirable however given the potentially limitless unique circumstances that go into each professional practice, including the existence of factors that require significant subjective assessment such as the existence of personal and business goodwill and the associated risks, it is unlikely to be possible to determine multiples this way without creating unfair results .

[188] At 266.
[189] See further discussion in chapter three at 3.3.2.

It is often suggested that if legislators desire to limit judges deliberative freedom they may wish to provide a checklist of factors to which judges must have regard. [190] There is potential scope to apply such law-making to the determination of a multiple when valuing professional practice interests. Common factors involved in professional practice valuations could be extracted from case law and the AES-2 valuation standard discussed in chapter one.[191] However, despite providing parties some certainty as to the factors the court must consider when valuing these interests, a checklist of factors will not, as H.L.A Hart notes, help to determine the relative importance and weight that each factor should be given.[192] Furthermore, discretion to consider further factors, given the unique circumstances of each case, would still be required.

In the absence of any rule based solution to limit judicial discretion when determining a multiple under the capitalisation of super profits methodology the most the Court can do is ensure that the discretionary process is not arbitrary. Glazebrook J comments on the process in *Scott v Williams*:[193]

> Experts must explain all their inputs, including how they arrived at the particular multiple and what it represents (for example how it relates to risk and/or growth). This means explaining the factors taken into account in deciding on the appropriate multiple with, as far as possible, an indication of how much (in numerical terms) the particular factor plays in the assessment as to the appropriate multiple. This enables the differences between the experts to be identified and an appropriate adjustment made if a judge does not accept the evidence of an expert on one or more of the factors relied on by that expert.

Ensuring that the discretionary process is as robust as Glazebrook J describes is perhaps the only possible and appropriate approach to determining a multiple at this time that will accommodate a fair and just division of relationship property.

4.2.5 Distinguishing between personal and business goodwill

[190] Miles, above n 164, at 270.
[191] See chapter one at 1.5.
[192] HLA Hart "Discretion" (2013) 127 Harvard Law Review 652 at 659. A paper drafted in 1956 and published posthumously in 2013. See also Miles, above n 164, at 270.
[193] At [112].

4.2.5.1 Formulaic approach

The use of rules to distinguish between personal and business goodwill has been widely explored. Of particular noteworthiness is the use of the objective and scientific Multi-attribute Utility Model (MUM) developed by David Wood.[194] The MUM is based on the Multi-attribute Utility Theory, a well established decision making model for subjective problems. The MUM is described as a step by step model used to determine the value of the two components of goodwill, personal and business, from the total goodwill in straightforward, objective and consistent manner.[195] The model produces a percentage weighting for both personal and business goodwill of total goodwill. This would allow the court to value personal goodwill and exclude it from the value of a professional practice interest.

David Wood describes the MUM methodology in seven steps:[196]

1. Define an objective.
2. Establish the Alternatives.
3. Define the separately the attributes of the business that make up personal goodwill and the attributes that make up business goodwill.
4. Measure the utility of each attribute by assigning two numbers ranging from 1-5 to each attribute. The first number signifies the importance of the attribute to generating earnings. The second focuses on the existence or prevalence of the attribute.
5. Aggregate the results. This involves using the mathematical formula at Appendix 1.
6. Evaluate the alternatives.
7. Express an opinion.

The outcome of the steps in the model is best illustrated by the table in Appendix 2.

However, the use of such an approach in the valuation of professional practice interests is questionable and complex. The MUM has not yet been adopted by the courts in any jurisdiction. Furthermore, Suzanne Delbridge comments that its use, whilst favourably

[194] See David Wood "An Allocation Model for Distinguishing Enterprise Goodwill from Personal Goodwill" (2004) 18(3) AJFL 167.
[195] Wood, above n 194, at 168.
[196] At 168-173.

accepted by some, is not unanimous.[197] This is largely due to the subjectivity the valuer has in determining what the attributes of the business are and the measurement of the utility of each attribute by importance and existence by applying a 1-5 number scale.[198] The subjective weighting system the MUM adopts is likely to cause further disagreement between expert valuers rather than remedy it causing further uncertainty in the distinction. Furthermore, the MUM is not a straightforward assessment that can be easily and practically used by the courts. The assessment is likely to be time consuming and require significant expertise and skill to apply. Therefore, the use of the MUM will not resolve the current inconsistencies with the principle of cost-effectiveness under s 1N(D) of the PRA.

4.2.5.2 A checklist of factors

Alternatively, the division of goodwill into personal and business components, by both the courts and expert valuers, may be aided by the existence of a checklist of factors that must be considered when making this assessment. These factors could be derived from a number of sources. Suzanne Delbridge laid out a number of factors that drive the analysis involved in dividing personal and business goodwill including:[199]

(a) the size of the business;
(b) whether the provision of personalized services offered by one or a few key individuals is a significant component of the revenue the business derives;
(c) whether a high degree of skill or knowledge is required to provide these services;
(d) whether customer relationships are principally held by one or few key individuals as opposed to the business; and
(e) whether the knowledge of the services provided by the business are held by one or a few key individuals.

Furthermore, factors could be extracted from case law. Both the majority and minority in *Scott v Williams* considered whether there was in existence a succession plan in order to transfer any personal goodwill as an important factor.[200] A checklist of factors could be legislated and

[197] Suzanne Delbridge "The Valuation of Personal Goodwill" (paper presented to the CAANZ Business Valuation and Forensic Accounting conference, Sydney, August 2018) at 11.
[198] Delbridge, above n 197, at 11.
[199] Delbridge, above n 197, at 9-10.
[200] At [140] per Glazebrook J, and [439] per William Young J.

would combat uncertainty by guiding judicial discretion and allowing a more consistent analysis to be undertaken when determining the existence of personal goodwill as opposed to business goodwill. Whilst the checklist of factors is a bare minimum approach to limiting judicial discretion, such reform would at least allow more certainty as to how the court will approach the distinction whilst still allowing for individualised and just division in the circumstances of each case.

4.3 Single joint experts

Another approach could be to reform the procedure around expert valuation evidence. Most experts used in valuation disputes involving relationship property are selected, instructed and called by the parties. Conversely, the use of expert evidence in matrimonial cases in England and Australia is commonly adduced through the use of a jointly appointed single expert appointed by the parties. Whether valuation disputes concerning professional practice interests in New Zealand would benefit from the use of single joint experts is therefore a question that must be addressed.

4.3.1 The approach in England and Australia to expert evidence

The role of the expert witness in litigation has been the subject of scrutiny and evaluation in both Australia and the United Kingdom with the aim of improving access to justice and reducing the cost of litigation.[201] In 1994 Lord Woolf was appointed to review the current rules and procedures of the civil courts in England and Wales. The *Woolf Report* was released in 1996 and made a number of recommendations concerning the role of the expert witness in litigation including that single experts be appointed jointly by the parties or the Court where there is a substantially established area of knowledge.[202] Similarly in 2002 the Family Court of Australia released the discussion paper *The Changing Face of the Expert Witness*.[203] The paper made 24 recommendations, many similar to those in the *Woolf Report*, including greater use be made of the power of the court to appoint an expert and direct that evidence be given by a single expert witness only.

[201] Jefferson and Moriarty, above n 16, at 240.
[202] Rt Hon Lord Woolf *Access to Justice: Final Report* (Her Majesty's Stationery Office, London, December 1996).
[203] Family Court of Australia *The Changing Face of the Expert Witness* (Discussion Paper, January 2002).

As a result the rules of civil procedure in both Australia and England now include provision for the appointment of a joint single expert. In the Family Court of Australia the appointment of experts is governed by the Family Law Rules 2004 (Cth). Rule 15.44 of the Family Law Rules 2004 (Cth) allows parties to agree to jointly appoint a single expert witness to prepare a report in relation to a substantial issue. M C Livesey QC of Bar Chambers in Adelaide comments that in the Family Court the parties are "routinely encouraged to select and instruct a single expert."[204]

Similarly in England, the appointment of experts is governed by Part 35 of the Civil Procedure Rules 1998 (UK) and in family law proceedings by Part 25 of the Family Procedure Rules 2010 (UK). Jay Shaw of Grant Thornton comments that the Family Procedure Rules favour the appointment of a single joint experts as opposed to party appointed experts.[205] Under these rules the parties can jointly select and instruct evidence to be given by a single expert. The court can also direct that evidence is given by a single expert even if this is against the wishes of the parties.[206] However where a single joint expert is appointed it is always open to either party to challenge the evidence of the single joint expert and apply for permission to put in its own expert evidence.[207]

4.3.2 The use of single joint experts in New Zealand

The rules that expert witnesses must comply with in court proceedings, as outlined in chapter one, are found in the Evidence Act 2006 and the relevant court rules.[208] This includes complying with the Code of Conduct for Expert Witnesses found in Schedule 4 of the High Court Rules 2016.[209]

[204]M C Livesey "The Effectiveness of Expert Evidence" (paper presented to the Australian Bar Association Conference, London, July 2017) at [37].
[205] Jay Shaw "The single joint expert process – a specialist's view" (2015) 16(4) Family Advocate 22 at 22-23.
[206] Civil Procedure Rules 1998 (UK), r 35.7; and Family Procedure Rules 2010 (UK), r 25.7.
[207] See *Daniels v Walker* [2000] 1 WLR 1382, 1387; and *Cosgrave v Pattison* [2001] CP Rep 68. See also Tristram Hodgkinson and Mark James *Expert Evidence: Law and Practice* (2nd ed, Sweet & Maxwell, London, 2007).
[208] See further discussion in chapter one at 1.6.
[209] High Court Rules, r 9.43; and District Court Rules, r 9.34.

As illustrated the capitalisation of super profits methodology for valuing professional practice interests can be made significantly more straightforward and consistent through the use of a both rules and discretion.[210] If experts, in addition to the above rules, were required to comply with the proposed options for reform, namely the determining a hypothetical notional salary from average salary figures and having regard to a list of factors when identifying and distinguishing between personal and business goodwill and its effect on the multiple, then the use of single joint experts appointed by the court for the valuation of professional practice interests in New Zealand would be tolerable. This is largely because the greater certainty provided by the suggested approach would significantly reduce the scope for disagreement between experts in the courts and allow for consistent outcomes.

The use of a single joint expert would have substantial benefits for relationship property litigation involving valuation disputes. The aim of using a court appointed single expert is to "overcome prohibitive delays and costs and to ensure independence."[211] By using only a single expert and ruling out any scope for disagreement between multiple experts the length of time that experts have to be involved in valuation disputes would be reduced and thus likely significantly reduce costs.

The use of single joint experts would reduce the potential for bias, in favour of the instructing party, on the part of any expert. Currently there is tension between the adversarial system and an expert's requirement to act objectively with a primary duty to the court.[212] The use of single joint experts as opposed to party appointed experts avoids selection bias that arises when parties shop around for the expert whose opinion best supports their position. Instead the use of single joint experts appointed by the court would result in the establishment of recognised panels of experts as commentary on what has developed in Australia outlines.[213]

Issues regarding the provision of information and the difference of information obtained by experts on opposing sides to litigation would also be significantly reduced by the use of a single expert jointly appointed by both of the parties. A single joint expert would likely have greater

[210] Through the use of rules to standardise the determination of a hypothetical notional salary and providing a list of factors to which the court must have regard to when identifying and distinguishing between personal and business goodwill to be used in the capitlisation of super profits methodology.
[211] Jefferson & Moriarty, above n 16, at 243.
[212] See further discussion in chapter three at 3.4.2.
[213] Tony Weber "In Support of a Single Expert Regime" Tony Weber Associates Limited <http://tonyweber.co.nz/in-support-of-a-single-expert-regime/>.

access to information from by both parties. This would avoid disagreements caused by valuations based on different underlying evidence and increase the accuracy of the calculation.

As in England, subject to the discretion of the court, leave for parties to adduce their own evidence would need to be allowed in novel circumstances in order to ensure that the court can provide for a just division of relationship property. Jefferson and Moriarty suggest that inevitably parties in valuation disputes will frequently retain their own shadow experts to challenge any report from a joint single expert.[214] This is more likely if the current discretionary approach of the capitalisation of super profits methodology is retained given it allows for considerable differences in the outcome of the calculation. If this was to occur the proposed reduction in costs and delays would inevitably disappear. However, the use standardised salaries and a checklist of factors to distinguish between personal and business goodwill within the capitalisation of super profits methodology would provide consistency in the outcomes and reduce the scope for disagreement. This would mean parties are less likely to significantly disagree with the outcome of the valuation, reducing the need to challenge the single joint experts report. Furthermore, the discretion of the court to grant leave to parties to adduce further evidence from a secondary expert could be limited to extraordinary circumstances in order to prevent the use of shadow experts.

4.4 Provision of information to single joint experts

Finally, reform to the rules of disclosure in the Family Court will ensure single joint experts are provided with the information necessary to undertake the valuation of a professional practice interest cost-effectively and without delay.

4.4.1 Family Court Procedure in New Zealand

Rules 388 to 416 of the Family Court Rules 2002 govern proceedings under the PRA. These rules outline a number of requirements including that an applicant who applies for an order under section 25(1)(a) of the PRA must file with the application an affidavit of assets and liabilities in form P(R) 1.[215] The affidavit must include details of any interest in business or

[214] Jefferson & Moriarty, above n 16, at 243.
[215] Family Court Rules, r 398.

partnership, the nature of the business and principal sources of income and the most recent annual financial statements. This limited information however is far less than is required to value a professional practice interest.

Currently parties engage their own separate experts to present evidence in court. This means interlocutory powers are often required to be used to obtain information required by the expert that is in the control of a party who is unwilling to disclose it. There are four broad interlocutory powers available to assist parties listed by the court in *Brainich v Ward*:[216]

1. Order discovery of documents;[217]
2. Order the administration of interrogatories;[218]
3. Direct an examination of a recalcitrant party;[219] or
4. Direct a s38 enquiry.[220]

However, such actions in pursuing discovery are both costly and cause significant delays to the proceedings.

4.4.2 The approach in England and Australia to disclosure in the Family Court

The Family Court in England is governed by the Family Procedure Rules 2010 (UK). Part 9 governs applications for financial remedy which divides disclosure into a two-stage process. The first stage under Rule 9.14 requires that once an application for financial remedy has been filed, both parties must, not less than 35 days before the first appointment, simultaneously exchange with each other and file with the court a financial statement in the form referred to in Practice Direction 5A. Rule 9.14(5) details the second stage. Not less than 14 days before the hearing of the first appointment, each party must file with the court and serve on the other party, amongst other things, a concise statement of the issues between the parties and a questionnaire setting out by reference to the concise statement of issues any further information and documents requested from the other party.[221]Furthermore, at the first appointment the

[216] *Brainich v Ward* [2016] NZHC 2481 at [41].
[217] Family Court Rules, r 140-155.
[218] Family Court Rules, r 137.
[219] Family Court Rules, r 400(2)(a).
[220] Family Court Rules, r 400(2)(b).
[221] Family Procedure Rules 2010 (UK), r 9.14(5).

Court must determine the extent to which any questions seeking information under rule 9.14(5)(c) must be answered and what documents requested must be produced.

In Australia, rule 13.01 of the Family Law Rules 2004 (Cth) imposes a general duty of disclosure providing that each party to a case has a duty to the court and to each other party to give full and frank disclosure of all information relevant to the case, in a timely manner. This includes full and frank disclosure of the party's financial circumstances, including any professional practice interest.[222] Of particular note is that at least 2 days before the first court date in a property case, each party must exchange with each other party a copy of a number of documents including the following relating to a partnership:[223]

(a) a copy of the financial statements for the 3 most recent financial years, including balance sheets, profit and loss accounts, depreciation schedules and taxation return; and
(b) a copy of the partnership agreement.

4.4.3 Application of a two-stage approach in New Zealand

One potential option for reform to Family Court procedure in New Zealand is to adopt a two-stage process of disclosure as occurs in England. A similar process could be used in New Zealand to allow the court to assess what information is required by the single joint expert and require the disclosure of that information. The first stage would require that once an application for an order under section 25(1)(a) of the PRA has been made both parties would have to submit an affidavit of assets and liabilities to the single joint expert. The second stage would require the single joint expert to file with the court a request for any further information and documents and the court to determine what information and documents must be produced. This will increase the timeliness of the provision of information to single joint experts and compel disclosure in situations where one party holds the information.

[222] Family Law Rules 2004 (Cth), r 13.04. This rule applies to a financial case. A financial case includes an application to the property of a marriage or de facto relationship after a breakdown of that relationship. See also Lynda Kearns "Laying Your Cards on the Table; Disclosure Roulette" (paper presented to the University of Otago A Colloquium on 40 years of the PRA: Reflection and Reform conference, Auckland, December 2016).
[223] Family Law Rules 2004 (Cth), r 12.02 and 12.05. Disclosure of documents relating to partnership only required if the party has a duty of disclosure under rule 13.04.

4.4.4 Better 'front-end' disclosure in New Zealand

The PRA could also require certain documents related to the professional practice interest to be provided at the time of the initial filing of the affidavit of assets and liabilities.[224] If a party holds a partnership interest in a professional practice New Zealand could adopt the Australian requirement of requiring the provision of a copy of the financial statements for the 3 most recent financial years, including balance sheets, profit and loss accounts, depreciation schedules and taxation return and a copy of the partnership agreement. This enables the single joint expert to receive such information timely and cost-effectively. Whilst further information will still be required in order to value a professional practice interest given the unique circumstances of each partnership it is not possible to outline what information needs to be provided in advance. Further information required could be requested using the two-stage process above. This reform would ensure relationship property disputes can be dealt with as inexpensively, simply and speedily as is consistent with justice in line and not hampered by inadequate disclosure.

4.5 Summary

This analysis illustrates that it is a mix of both rules and discretion within the capitlisation of super profits methodology, through the use of the use standardised salaries and a checklist of factors to distinguish between personal and business goodwill within the capitalisation of super profits methodology will ensure certainty and consistency within the approach to valuing professional practice interests whilst still allowing for individualised justice in each set of circumstances. This reform combined with the use of single joint experts and tightening the law governing disclosure in the Family Court will allow the courts to achieve a fair and just division for the parties to a dispute in a cost-effective and speedier manner in line with the purposes and principles of the PRA.

[224] See Kearns, above n 222, at 8-9 where a similar proposal for reform, although in regard to the uncovering of assets and liabilities, was suggested.

CONCLUSION

Whilst family law has been described as existing in a "perpetual state of flux" the law governing the division and valuation of relationship property under the PRA has remained relatively constant.[225] This is despite significant difficulties in the current approach meaning such issues are difficult to resolve short of litigation which can cause individuals significant financial and emotional burden.

This critical analysis has focused on the current approach to valuing professional practice interests, a task that has troubled the court and litigants since the decision that Mr Z's interest in an accounting firm and the bundle of rights that attached to it was property capable of division under the PRA.[226]

The issues with the status quo are significant. At the crux of these issues is the contradictions of the current approach to the principle under s 1N(d) of the PRA that questions arising under the PRA should be resolved as inexpensively, simply and speedily as is consistent with justice. This is in large part due to the need for expert valuers and the capitalisation of super profits methodology committing disputing parties to time and expense which often out of scale to what is involved. The difficulties with the current use of this methodology, which fuel this overarching issue, are the complexities, arbitrariness and subjective nature of the determination of a hypothetical notional salary and an appropriate multiple to be adopted as well as the difficulty in the distinction between the elusive personal and business goodwill. Furthermore, the scope for disagreement between experts allowed by the approach to obtaining and adducing evidence exacerbates time and expense. Therefore, if a fair and just division is one which has regard to the purpose and principles of the PRA, including that disputes are resolved cost-effectively and efficiently, then the current approach to valuing professional practice interests cannot be said to achieving a just division.[227] A highly discretionary and individualised approach to achieving justice is no longer appropriate. If the law is primarily concerned with ensuring the fair and just division of relationship property, as opposed to the scientific certainty of the valuation exercise, then the approach needs to be changed.

[225] Mark Henaghan "Family Law" (2016) 2 New Zealand Law Review 357 at 392.
[226] *Z v Z (No 2)*, above n 69, at 282.
[227] *M v B*, above n 50, at [227].

There is no simple solution to this dilemma. However as Joanna Miles and Rebecca Probert comment "…although a "one-size-fits-all" approach is likely to be inappropriate in this complex area, there is scope for a more standardised approach to ancillary relief than currently exists."[228] Reforming the law in a number of ways would alleviate many of the issues described above. The mix of both rules and discretion within the capitlisation of super profits methodology, through the use of the use standardised salaries and a checklist of factors to distinguish between personal and business goodwill within the capitalisation of super profits methodology will ensure certainty and consistency within the approach to valuing professional practice interests whilst still allowing for individualised justice in each set of circumstances. This reform combined with the use of single joint experts and tightening the law governing disclosure in the Family Court will not only make it easier for parties to settle out of court but where litigation is necessary it will allow the courts to achieve a fair and just division for the parties to a dispute in a cost-effective and speedy manner. This will ensure that the valuation of professional practice interests is consistent with both the purposes and principles of the PRA.

[228] J Miles and R Probert "Sharing Lives, Dividing Assets: Legal Principles and Real Life" in J Miles and R Probert *Sharing Lives, Dividing Assets: An Inter-Disciplinary Study* (Hart Publishing, Oxford, 2009) at 19. See also Mark Henaghan and Bill Atkin *Family Law Policy in New Zealand* (4th ed, Lexis Nexis, Wellington, 2013) at 209-210.

APPENDIX 1: THE MUM MATHEMATICAL FORMULA

$$\text{TMU PGA} = \sum[IU^{\text{PGA for 1 to N}} \times EU^{\text{PGA for 1 to N}}]$$
$$\text{TMU EGA}^{20} = \sum[IU^{\text{EGA for 1 to N}} \times EU^{\text{EGA for 1 to N}}]$$
$$\text{TMU} = \text{TMU PGA} + \text{TMU EGA}$$

$$\text{Personal Goodwill} = \frac{\text{TMUPGA}}{\text{TMU}} \times \text{Total Goodwill}$$

Where: TMU PGA = Total Multiplicative Utility for Personal Goodwill
TMU EGA = Total Multiplicative Utility for Enterprise Goodwill
TMU = Total Multiplicative Utility
PGA = Personal Goodwill Attributes
EGA = Enterprise Goodwill Attributes
IU = Importance Utility
EU = Existence Utility
1 to N = Each of the attributes selected for the analysis.

Source: Suzanne Delbridge "The Valuation of Personal Goodwill" (paper presented to the CAANZ Business Valuation and Forensic Accounting conference, Sydney, August 2018) at 12.

APPENDIX 2: EXAMPLE OUTCOME OF THE MUM

Multi-Attribute Utility Model

Professional Goodwill Attributes (PGA)	Importance Utility	Existence Utility	Mult. Utility	Percent
Ability, Skill and Judgement	5	4	20	13.07%
Personal Reputation	3	4	12	7.84%
Work Habits	3	4	12	7.84%
Closeness of Contact	3	3	9	5.88%
In-bound Personal Referrals	3	3	9	5.88%
Staff, Personal	3	4	12	7.84%
Age and Health	1	4	4	2.61%
Important Personal Nature	1	2	2	1.31%
Marketing and Branding	1	4	4	2.61%
Personalized Name	1	-	-	0.00%
Total Multiplicative Utility (PGA)			84	54.90%
Personal Goodwill Allocation (Rounded)				55%

Enterprise Goodwill Attributes (EGA)	Importance Utility	Existence Utility	Mult. Utility	Percent
Business Location	5	2	10	6.54%
Business Reputation	5	2	10	6.54%
Repeating Revenue Stream	5	2	10	6.54%
Systems and Organization	5	2	10	6.54%
Multiple Service Providers	5	1	5	3.27%
Business Name	3	3	9	5.88%
Inbound Referrals	3	2	6	3.92%
Staff, Enterprise	3	2	6	3.92%
Marketing and Branding	3	1	3	1.96%
Multiple Locations	1	-	-	0.00%
Total Multiplicative Utility (EGA)			69	45.10%
Enterprise Goodwill Allocation (Rounded)				45%

Total Multiplicative Utility (PGA+EGA)	153	100.00%

(1) Importance Utility is ranked in three categories - key (5), more important (3), important (1).
(2) Existence Utility is weighted from 0-4. 0 indicates no presence, 4 indicates strong presence.

Veterinary practice example.

Source: Suzanne Delbridge "The Valuation of Personal Goodwill" (paper presented to the CAANZ Business Valuation and Forensic Accounting conference, Sydney, August 2018) at 12.

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