Martin v Martin

Submitted by Jessica Armfelt on Tue, 01/22/2019 - 11:00

One of the challenges facing those of us practising in the field of financial remedy is how to deal with a private family business operated by one of the parties to the marriage. Such businesses are often the source of much of the parties' wealth and may well be the source of most of their future income. Many issues then arise, including how the company is to be valued; how to balance risk; how funds are to be extracted; whether or not shares can be transferred to the other party; the effect on third parties; tax; and, if periodical payments are to be paid, whether or not it is double-counting to include the company as both a capital asset and an income-producing asset.

The leading authority remains that of *Wells v Wells* [2002] EWCA Civ 476 where Thorpe LJ said:

"Having read the skeleton arguments and the judgment we were at once struck by the security of the result that the wife had achieved in contrast to the risks confronting the husband's economy. The family's standard of living has throughout been dependent upon the fortunes of the husband's business. Had the marriage survived the family would undoubtedly have shared adversity as it had shared prosperity. The years of marriage comprise the years of the husband's commercial vitality between his late 30s and his mid 50s. The harvest of those years is represented by the concrete assets totalling £1.823M. But the future years look hazardous. It seems unlikely that the husband will restore the pattern of prosperity and savings from income in the years ahead. After all if it is reasonable for him also to seek to retire at 60, he has only five years in which to recover the profitability without which Soundtracs will not be easily realisable for significant value. In principle it seems to us that the separation of the family does not terminate the sharing of the results of the company's performance. That is easily achieved in any case in which the wife's dependency is met by continuing periodical payments. It is less easy to achieve in a clean break case. In that situation, however, sharing is achieved by a fair division of both the copper-bottomed assets and the illiquid and risk laden assets. After all the wife was already a shareholder in Soundtracs and a substantial increase in her shareholding would at least have enabled her to participate in future prosperity by dividend receipts or capital receipts on sale or a cessation of trade. An increase in her share of the illiquid and risk-laden asset would have allowed a reduction in the Duxbury fund, if not in the housing fund. If profitability were not recovered then both parties would share the experience of a marked reduction in standards of living."

The Court of Appeal raised the possibility of sharing the company between Mr. and Mrs. Wells but were rebuffed by both parties:

"At the outset of the appeal we enquired as to the extent that this approach had been canvassed at the trial. It became plain that the husband's priority at trial was to retain the company with a larger

share of the hard assets than the judge allocated. We were referred to expert evidence from his accountant who asserted that the company's future operation would be handicapped if not crippled were the wife to become a substantial shareholder. The expert evidence from the wife's accountant challenged that proposition but suggested instead that a substantial transfer of Soundtracs shares to the wife would create a CGT liability. No doubt because the husband wanted his shares, there was no response to the CGT point. In this court Mr Posnansky, having taken instructions from his client, was more receptive to the solution of a significant sharing of the risk-laden asset in return for a greater share of the concrete assets. However his primary case was for a fairer division of the concrete assets without any adjustment of their respective holdings in Soundtracs. Miss Baron was understandably resistant to the court's proposition. She submitted that neither party had sought that outcome and it was inconceivable the court would impose it, thereby creating an unnecessary tax charge. On this aspect of the case Miss Baron's submissions undoubtedly prevail. Whilst it might have been an option for the judge it is plainly not an option for this court in present circumstances."

The parties' reluctance to share the company is familiar and understandable: it is rarely a good idea for parties to remain (or become) co-shareholders in a company post-divorce, given the likelihood of the need for complicated shareholders' agreements to protect both parties; one from interference and the other from the company being run to their disadvantage.

Nevertheless, sometimes circumstances may dictate that there is no alternative to a Wells sharing arrangement. So in *Veersteegh v Veersteegh* [2018] EWCA Civ 1050 it was said:

"I fully accept that the making of a Wells order is something that should be approached with caution by the court and against the backdrop of a full consideration by the court of its duty to consider whether it would be appropriate (per s25A MCA 1973), to make an order which would achieve a clean break between the parties…

Unattractive as a Wells order is as an outcome for both the wife and the husband, it is hard to know what else the judge could have done given the impossibility of valuing the shares or in estimating future liquidity.

It follows that I dismiss the appeal. Having said that, I would in conclusion respectfully adopt the following words from the concluding paragraphs of the judgment of Thorpe LJ in Wells:

"I would also urge the parties to have regard to the opportunity that still presents itself for them to come to a better solution by negotiated or mediated means. We are conscious that the parties, who are not inhibited as we are, may do better."

In the usual course of events one of the parties, still usually the husband, will retain the company and will argue that by doing so he is retaining the riskiest asset and as a result he should receive more than 50% of the overall total. This is how Wells has been generally interpreted:

"On familiar Wells principles, if the wife has liquid assets and the husband has much of his wealth in shares, it is fair and reasonable that I should make an order leaving the husband with a greater percentage of the assets."

SJ v RA [2014] EWHC 4054.

That approach has now been thrown into doubt by the case of *Martin v Martin* [2018] EWCA Civ 2866. This was an appeal from Mostyn J in which the Judge diverged from the *Wells* orthodoxy and simply divided the assets 50/50, even though a large part of the husband's award was shares in a private company and he was therefore retaining the bulk of the risky assets. Mostyn J's reasoning was as follows:

“A valuation of an asset is the estimate of what it will sell for now. If it is perceived as being hard to realise then its value will be discounted to reflect that difficulty. It does seem to me to use discounted figures and then to move away from equality is to take into account realisation difficulties twice. Whatever the asset the only difference between it and its cash proceeds is, as Thorpe LJ once memorably said, the sound of the auctioneer's hammer."”

In other words, any reputable valuer will take into account the risky nature of the assets in arriving at his or her valuation, so it is double-counting also to award them more than 50% of the overall assets for the very same reason. To do so would be a form of the “lawless science” of which this Judge so famously disapproves.

Both parties appealed and the Court of Appeal identified the principal issue raised by the case as whether the judge was right to take the valuation of the company as equivalent to cash.

Unsurprisingly, the Court of Appeal concluded that the answer to this question was “no”, and in doing so quoted from Versteegh in which the orthodoxy of Wells was restated and where Lewison LJ said:

"*… the difference in quality between a value attributed to a private company on the basis of opinion evidence and a sum in hard cash is obvious*".

The *“auctioneer’s hammer”* quotation from Thorpe LJ was found to be inapposite, on the basis that in the case from which the quotation was taken (*White v White*) the asset in question was farmland which is well known to be a stable investment and in no way comparable to shares in a private trading company.

In allowing the husband’s appeal in *Martin* the Court of Appeal said:

“Accordingly, even if we were not bound by precedent, I consider (a) that, contrary to Mr Pointer's general submission, assets have different levels of risk; and (b) that, as a matter of principle, the court must take this into account when applying the sharing principle.”

Such an outcome is likely to be met with sighs of relief amongst the profession, most of whom have been advising clients since *Wells* that in striving to arrive at an outcome which is fair to both parties the court will take into account not only the value of the assets but their nature. Any outcome other than a win for the husband in *Martin* would have been to endorse a refusal to discriminate between the different classes of assets and instead to treat them all the same.

But, as usual, the principle is easier to state than to understand. In what way should the risky nature of the assets be taken into account if not be awarding the holder more than 50% of the assets? The Court of Appeal failed to give any guidance, but maybe this was inevitable, given the infinite variety of companies and risks attached to them.

Maybe the answer is simply that the risky nature of the assets will now be taken into account not so much in the percentage division but more in the time and methods permitted to satisfy the award. So in *Martin* itself the appeal was allowed (because of the Judge’s refusal to distinguish between the two types of assets), but his award was permitted to stand, with the only variation being to give the husband longer to pay (four years rather than one to find £20m). No doubt in large part the outcome was influenced by the size of the numbers involved, which of course takes it a long way from the average case.

The Court of Appeal endorsed Mostyn J’s use of a straight-line valuation of the shares at the outset of the relationship, working back from their value at its end, and deprecated the use of expensive attempts to assess the actual value of the shares many years ago.

Martin is essential reading and provides useful guidance as to how shares in private companies should be treated by the courts and should be the first weapon in the armoury of those seeking to defend a claim that the party who is taking the risky assets should receive more than 50% of the assets.

Nicholas Sproull

Specialist Areas:
Matrimonial Finance

Albion Chambers
Broad Street
Bristol
BS1 1DR
Telephone: 0117 927 2144
www.albionchambers.co.uk