Active and Passive Growth (Business)

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Some attempted definitions!

1. **Active economic growth (AEG):** growth as a result of contributions of one sort or another made during the marriage, i.e. of activity, irrespective of whether such is achieved with the assistance of a spring-board already in place.

2. **Passive economic growth (PEG):** the increase in value of a non-matrimonial asset not attributable to activity on the part of the 'owner'.

Rationale

3. Arguments as to PEG and AEG come into play in relation, principally, to non-matrimonial assets and property (and can apply just as forcefully to more standard inherited assets, not just company valuations).

4. **JL v SL (2015) para 18:** "*Matrimonial property is the property which the parties have built up by their joint (but inevitably different) efforts during the span of their partnership. It should be divided equally. This principle is reflected in the statutory systems in other jurisdictions. It resonates with moral and philosophical values. It promotes equality and banishes discrimination.*"

5. "*These arguments to not apply to property received or created outside the span of the partnership, or gratuitously received within the partnership for an external source. Such property has little to do with the endeavour of the partnership and*

the equal sharing principle as explained by lord Nicholls (in White v White) just cannot apply to it on any moral or fair basis" (para 19)

6. But c/f Lord Mance in Miller:

   " *On the other hand, where at the beginning (or end) of the marriage an actual transaction is under way or in view which in due course yields a considerable new asset, there is no difficulty in principle (even if there may be some difficulty in valuation) in accepting that part of that asset may have to be excluded from any assessment of matrimonial acquest or included in what the parties brought into the marriage. In the present case, Mr Miller already had, at the marriage date, real connections in the form of the Jupiter funds which he later took to New Star and real prospects under the gentlemen's agreement made with Mr Duffield of acquiring, as he subsequently did, valuable shares in New Star. I would regard these as real contributions brought into the marriage, which should on any view be taken into account accordingly.*"[1]

Counter-intuitive?

7. '*Passive growth of a non-matrimonial asset may be treated as non-matrimonial property, whereas increase in value attributable to the efforts of an actively working spouse during the marriage will likely fall into the matrimonial pot. At first this may seem counter-intuitive, with the hard-working businessman who takes over the family firm….being treated less favourably than the idle rich…..*' (The Family Business and Marriage, 2017, page 677).

Arguments for and against accounting for PEG

8. FOR: An allowance for PEG is fair so as to account for the inherent / intrinsic growth of an asset before considering the activity of an individual and its affect on that growth.

[1] Indicating a discretionary approach to an asset that could not in any way be described as non-matrimonial

9. AGAINST: Companies require active management to grow and can fail for many reasons, therefore, the basic concept of PEG is almost impossible to differentiate from AEG.

<u>Jones v Jones [2011] EWCA Civ 41</u>

10. This was the question in Jones v Jones: "*When an asset of a spouse – in this case a husband – represents the proceeds of sale of a company which he brought into the marriage and built up during it, how is the attribution of part of the proceeds to the husband's ownership of it at the date of the marriage to be conducted for the purposes of the sharing principle and, in particular, does the exercise of attribution permit focus not only on the value of the company at the date of the marriage but also on the husband's personal capacity at that date to build it up in the future?*"

11. Recalling that (1) the value of H's business was £2m at the date of the marriage (1996), £12m at the date of separation (2006) and sold for £25m in 2007…(2) the company supplied specialist gases and equipment to the oil and gas industry and H had started the business in 1986, and (3) Charles J had determined that 60% of the value of the company at the separation date represented H's own contribution (and was therefore non-matrimonial)….

12. <u>The CoA in Jones – allowing the appeal - followed these steps:</u>

    a. The £25m sale value in 2007 included any 'springboard'

    b. The value of the company at the date of the marriage was £2m (although this was doubled to £4m by the CoA, largely in recognition of the fact that an offer to purchase of £6m - £7m had been made just one year after the marriage date)

    c. Therefore, the adjusted value of the company at marriage was taken as £4m

    d. Other reasons for adjustment included passive economic growth (PEG). PEG was appropriate, despite this being a private company, and was calculated by reference to a Public Index.

e. PEG inflated the £4m 'at marriage value' to £8.7m (which was latterly rounded to £9m without any real additional reasoning).

Measuring PEG

13. Notoriously difficult and arbitrary (although, according to Jones, we should '*cease to be disconcerted by arbitrariness'* (para 35). And company values are, in any event, '*fragile….and ostensible accuracy is a chimera*' **(H v H [2008] EWHC 935).**

a. Inflation?

b. RPI or CPI?

c. A relevant index?

d. To what extent does the type of asset to which PEG is being applied affect the appropriate measuring tool?

LJ Wilson

44. In my view the second reason for adjustment is the need to allow for passive economic growth in the company between the date of the marriage and the date of sale. This was not a subject canvassed before the judge or at the time of the hearing before us so, at our request, counsel have made short submissions in writing upon it.

45. In Rossi v. Rossi [2006] EWHC (Fam) 1482, [2007] 1 FLR 790, Mr Mostyn, again sitting as a deputy judge of the Division, said, at [24.2],

"For the purposes of establishing the matrimonial property in respect of which the yardstick of equality will 'forcefully' apply the value of assets brought into the marriage

by gift and inheritance (other than the former matrimonial home), together with passive economic growth on those assets, should be excluded as non-matrimonial property. "

46. Like Singer J in S v. S (Ancillary Relief after Lengthy Separation), [2006] EWHC 2339 (Fam), [2007] 1 FLR 2120, at [111], I regard Mr Mostyn's proposition as helpful and (subject to the fact that the yardstick of equality has been subsumed within the sharing principle) as accurate. ***Take a work of art or land with potential for development which a spouse has owned since prior to the marriage and which, without activity on his or her part, has substantially increased in value during it.*** *The court would accept that the increase in its value during the marriage was as much non-matrimonial as its value at the date of the marriage: it would thereby allow for its passive growth. Passive growth is to be contrasted with growth as a result of contributions of one sort or another made during the marriage, i.e. of activity, irrespective of whether such is achieved with the assistance of a spring-board already in position. An analogous approach is apt in respect of assets inherited by, or given to, one spouse during the marriage.*

47. Two decisions at first instance demonstrate allowance for passive growth. In H v. H (Financial Provision: Special Contribution) [2002] 2 FLR 1021 the husband had during the marriage inherited in the U.S. assets worth £400,000 at the time of the hearing. In S v. S (Non-Matrimonial Property: Conduct) [2006] EWHC 2793, [2007] 1 FLR 1496, the husband had owned since before the marriage a portfolio of commercial properties worth £1m at the time of the hearing. The judges (Mr Hughes QC and Burton J respectively) classified the assets as entirely non-matrimonial. Neither sought to afford different treatment to the increase in value of the assets since the inheritance and the date of the marriage respectively; I doubt that it was even argued that they should do so.

48. It appears from the quotation in [23] above that in GW Mr Mostyn QC uprated assets of $500,000 at the date of the marriage to $781,000 in order to reflect their *"value in money today". Of course an increase reflective only of inflation would not be an allowance for growth in real terms at all; but it would presumably be apt for application to assets kept only in liquid form. Mr Pointer argues, however, that it is also apt for application to the present case. In that he does not concede allowance for the spring-board in place at the date of the marriage, he adheres to the professional valuation of the company at that date in the sum only of £2m and concedes an increase only to £2.7m, being reflective of the increase of 35% in the Retail Prices Index between the date of the marriage and the date of its sale.*

49. The crux of Mr Pointer's argument in this respect is that a small industrial company, such as was owned by the husband in the present case, requires active management and, even if well managed, may fail for a variety of reasons. There is in truth profound difficulty about quantifying an allowance for passive economic growth in such a case. But should the difficulty preclude its attempt? *If at the date of the marriage the husband's £4m (or, as Mr Pointer says, his £2m) had been invested in a portfolio of commercial properties, he, like the husband in S above, would have been the beneficiary of adjustment for any passive economic growth. If at the date of the marriage the husband's £4m had represented the value of a minority holding in a company in which he was no more than an investor but which operated in a field identical to that in which his company actually operated, he would again have been the beneficiary of adjustment for any passive economic growth.* ***I do not see how the law can logically decline to attempt to enquire into the existence and, if so, the amount of such growth by reference only to the nature of the husband's investment.***

50. Although I accept Mr Pointer's warning about the dangers inherent in attributing the level of success of public companies to small private companies, I believe that, in the light of its limited access to the relevant facts, ***this court now can do no better than to apply to the sum of £4m an increase of 116%, being the percentage increase in the FTSE All Share Oil and Gas Producers Index between the date of the***

marriage and the date of the sale. Thus allowance for passive growth lifts the figure of £4m to £8.7m.

51. It is therefore my view that the best application of Miss Stone's approach of which this court is capable would result in conclusions that the value of the non-matrimonial assets is £8.7m, say £9m; that the value of the matrimonial assets is therefore £16m; and that the award to the wife would be £8m.

<u>LJ Arden</u>

59. As to "passive growth", I agree that in principle, in the circumstances of this case, an allowance should be made even though the asset is a private company the business of which has developed and expanded (in this case exponentially) during the marriage. It may be difficult to compute growth on such an asset, as opposed to an asset such as a painting or vintage car or portfolio of investments that has always been kept separate and distinct. I would take the same view about making an allowance for growth even if there had been an amalgamation of the company's business with that of another company, though in such a case there may be even greater difficulties in practice in identifying the asset representing the original asset. ***But here there has been no change in company's line of business and the original line of business continued to form part of the business as it developed.***

60. However, I would query whether what Wilson LJ proposes in his judgment is really passive growth and reject the notion that the only growth that can be taken into account is passive growth. ***First, as a matter of principle, when valuing the non-matrimonial assets at the end of a marriage, the court should so far as it can look at what has actually happened and not at what might have happened. In parenthesis, I would add that, because of this principle of "reality", I would reject the graphs provided by Miss Stone seeking to establish the values of the company at certain dates based on an artificial assumption of a straightline***

growth up to eventual sale. Secondly, if only passive growth is taken into account, the law rewards the spouse who buries her non-matrimonial assets in the ground rather than the spouse who actively manages them. The correct analysis in my judgment, in circumstances such as the present, is that, where a spouse has a non-matrimonial asset of the present kind, he is entitled to that element of the company at the end of the day which can fairly be taken to represent the fruits of the non-matrimonial assets that accrue during the marriage, even if the fruits are the product of activity by him or on his behalf.

61. Moreover, here there was undoubtedly activity by the respondent in building up his company with outstanding success. I have no reason to doubt that he worked extremely hard to achieve his success. It is not therefore appropriate to add an allowance for inflation, as Mr Pointer urges us to do, but to try to find a barometer apt to measure the growth that actually occurred in this case. As an aside, Wilson LJ suggests that inflation might be appropriate in the case of assets kept in liquid form. It seems to me that an allowance for inflation would not necessarily in my judgment be appropriate in that case. Cash is likely to have been deposited with a bank and to have earned interest during the period of the marriage. This interest can be calculated and an appropriate sum can be added to the value of the non-matrimonial asset. In the unlikely event that cash had been kept in coin or notes (perhaps under the mattress), and in the likely event that it had then gone down in value, it is difficult to see why it is appropriate to make an allowance for the rate of inflation.

62. But how are such fruits to be ascertained when upon marriage the subsequent increase in value of the company becomes an asset that represents the matrimonial acquest? There is no evidence as to the rate of return on the non-matrimonial asset as a separate asset and therefore as Wilson LJ states the only approach the court can take is to find a suitable index for equity investments. This does not of course record the performance of Dominion, but of other companies in the market. But which index? Miss Stone suggests (without giving any reasons as to why it was appropriate to use this index) the FTSE Oil and Gas Producers Index. This index is based on the *performance of a small number of listed companies in that sector, including BP and Shell. There is no evidence that that is the relevant index as Dominion is not an oil or gas producer (or a listed company). It simply produces products for use in the drilling industry. But I am content to assume that Miss Stone's preferred index is an appropriate index because the fortunes of a company like Dominion (in particular, its turnover) may well follow those of the oil and gas production sector generally.*

63. I have above limited any statement of principle to circumstances such as the present. The company's growth in this case was exponential, leaving a surplus even when allowance is made for indexed growth. ***An allowance for growth in the manner proposed by Wilson LJ in this case simply cannot be used unless the company's growth has far outstripped the index sought to be used.***

<u>Robertson v Robertson [2016] EWH 613 (Fam)</u>

14. The ASOS case.

15. W's lawyers sought to apply *Jones v Jones* methodology to the case: extracting £4.84m as the value of the H's shares at marriage, uprated to account for PEG.

16. H 48 and W 43. Parties met 2002, married in 2004, separated in 2013 and had 2 children, aged 7 and 8. Special contribution argument rejected. W a home maker and mother. Value of ASOS shares at trial £219m.

17. Query in this case the matrimonial / non-matrimonial / hybrid nature of the shares?

18. Query also how the concept of mingling (or, at least, quasi-mingling) infects some of the judicial discretion.

19. Robertson is a case in which the methodology of Jones was rejected, principally for reasons particular to the facts of the case. Robertson, once again, is a paradigm example of the split between the (1) formulaic and (2) 'arbitrary' approach to financial division.

35 In the present case, pursuant to a direction by Moor J (which was resisted by the husband on the grounds of irrelevance), Mr Jason Lane BA, CTA, a partner of Saffery Champness, accountants, was instructed as a single joint expert "to report on the value in today's terms of [the husband's] shareholding/interest in ASOS at June 2002 and September 2002". His resulting report is one of great thoroughness and accountancy expertise and erudition at which one can only marvel, and to which I pay tribute. After an extensive investigation of publicly available material and also documents and information supplied on behalf of the parties (but he was instructed not to speak directly to either party), Mr Lane has expressed an opinion as to the passive growth upon the shares, and accordingly as to the value of the shares in June and September 2002 uprated to include that passive growth. ***He has expressly read the judgment of Wilson LJ in Jones v Jones and sought to apply the same methodology. He concludes that the percentage of passive growth since June 2002 has been 466 per cent, and since September 2002 (when the shares were trading at a lower price on the AIM) has been 488.9 per cent. This results in his conclusion that the gross value of the shares as at 13 January 2016 (the date of the report) is £6.7 million, allowing for passive growth since June 2002, and £4.9 million, allowing for passive growth since September 2002, resulting in net figures of £4.84 million and £3.56 million respectively.***

42 That, instinctively, seems to me to be so unfair to the husband on the facts and in the circumstances of this case, and so over-generous to the wife, that I propose, not merely by way of cross-check but in substantive exercise of my statutory duty, now to consider this case by reference to all the matters in section 25 of the Matrimonial Causes Act 1973 considered seriatim, though not in the order in which they there appear. In moving to this next stage of this judgment, I may appear to counsel not to have dealt at length with the many detailed points they made to me, and the many authorities upon which each rely in development of their arguments whether the ASOS shares are or are not matrimonial. I do not overlook those points and arguments, but I regard the debate as ultimately sterile. Further, the strongest united message to emerge from all three judgments in Jones is that first instance judgments in cases of this kind should be short, concise and avoid over-elaboration or over-sophistication.

60 Of course, a successful company does not stand still, but depends upon dynamic and visionary management. *Mr Bishop and Mr Bradley produced a written list of twenty "management decisions" under a heading "The active management decisions which grew ASOS as identified in the SJE's report", being decisions taken during the period of the cohabitation and marriage. These were not decisions taken by the husband alone. They were part of the management of the company by a large and expanding team, albeit led by him as CEO. As CEO and an employee of the company, the husband was, in any event, well remunerated with salary and additional shares, in which the wife has shared and will equally share.*

61 In my view, it does not fairly reflect these considerations to carve out from the current value of the shares a mere £4.8 million, as Mr Bishop and Mr Bradley, basing themselves on Mr Lane's report, contend. Much greater allowance must, in fairness to the husband, be made for the history in order, to borrow words from Lord Nicholls in Miller quoted in paragraph 38 above, to "reflect the amount of work done by the husband on this business project before the marriage". But, in my view, the pre-existing shares cannot, in fairness to the wife, be carved out and left out of account altogether. They were not simply left in a drawer, to use a metaphor used during the course of the argument. *They were part of the backdrop of the whole matrimonial economy; and to borrow words from Baroness Hale of Richmond in Miller quoted in paragraph 27 above, they were part of "the way the couple have run their lives".*

62 As the "Share Sales Valuation" schedule shows, the husband readily took the shares out of the drawer and sold them when the parties wanted to invest in new homes for themselves. He sold pre-existing shares for an estimated net £1.57 million in July 2008, shortly before the purchase of the house in Oxfordshire. He sold more pre-existing shares for an estimated £10 million net in July 2010, shortly before the parties bought the final matrimonial home. Although his and his alone, the shares were part of the family economy which the husband was quite willing to draw upon and spend for the *family as a whole. They cannot accurately be described as "ring fenced", as Mr Cohen submitted.*

63 In my view, not as an accountancy exercise, but in the exercise of broad judicial discretion, the only fair way to treat the remaining pre-existing shares (and the three Wimbledon investment properties) is to treat them as to half as the personal non-matrimonial property of the husband, and as to half as the matrimonial property of the parties to be evenly shared.

Final thoughts

20. Assessment and accounting for PEG and AEG has its place in cases but depends on (1) sufficient overall wealth and (2) particular circumstances justifying its application.

21. Those circumstances may related to (1) the type of company involved (2) having an appropriate index or formula to calculate PEG and (3) a more easily-identifiable distinction of pre-marital wealth.

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