

ESSEX COURT CHAMBERS

PROBLEM QUESTION

Mr Smith is the owner of an upmarket fish and chip shop "Cod & Chips" in Stratford, London. It is within walking distance of the proposed site for the Olympic village and stadium, where the London 2012 Olympic Games are due to begin at the end of July 2012. Mr Smith decides to sell his business, hoping to use the money raised to fund his retirement. He is introduced, through a friend, to a Miss Jones, an entrepreneur looking to make a short-term investment in a local business. Mr Smith is confident that, because of the Olympics, the turnover of "Cod and Chips" will double from £100,000 in 2011 to £200,000 in 2012. He explains this to Miss Jones, who is thoroughly impressed and makes financing arrangements with her bank.

Mr Smith and Miss Jones decide to enter a share sales agreement. There are successive drafts and each one is closely negotiated. Both parties receive legal advice from local firms of solicitors. Through her solicitors, Miss Jones obtains the financial statements for "Cod and Chips" for the last three years. She examines them to ensure there is no room for growth, as predicted by Mr Smith, and that the business can cope with a large increase in custom. She is satisfied on both counts.

In the course, of correspondence before the agreement is finalised, Miss Jones' solicitors write to Mr Smith's solicitors to say:

"It is imperative that Miss Jones has protection in the event that the Olympic Games do not happen, as planned in London's East End. Moreover, she is not prepared to take the risk that your client's prediction that revenues will increase to £200,000 will turn out to have been over optimistic. Please find enclosed draft agreement which protects our client's position."

The enclosed draft agreement contains, among others, the following clauses:

Clause 1: *"The Seller warrants that the turnover of the business in 2012 shall be no less than £200,000"*

Clause 2: *"In the event that the Seller is in breach of any of its warranties contained in this Agreement, the Purchaser shall be entitled, at its option, to sell back to the seller the shares at three times the Original Sale Price"*

Clause 3: *"If, for whatever reason, the Olympic Games do not take place, the Purchaser shall be entitled, at its option, to sell back to the Seller the Shares at three times the Original Sale Price"*

In their subsequent letter Mr Smith's solicitors say: *"Our client has considered the draft agreement proposed by your client. He agrees, in principle, that your client should be protected in the event that the Olympics do not take place as planned. However Clauses 2 and 3 go too far: they are punitive, excessive and unnecessary"*.

In response Miss Jones' solicitors explain that: *"If your client stands by his assessment of the business' prospects, then he should not have a problem agreeing to these clauses: if he is right, Miss Jones will not need to rely on them. From Miss Jones' perspective, these are not negotiable"*.

Following several rounds of correspondence, Mr Smith's solicitors agree to all of the above clauses, which form part of the final draft, signed by both parties on 1 July 2011. Miss Jones acquires the entire issued share of capital in "Cod and Chips" for £100,000 ("the Original Price").

Advise Miss Jones in the following alternative scenarios.

Scenario 1

It is now January 2013. Miss Jones had taken over the premises of "Cod and Chips" in July 2011. After a successive eleven months of trading, in May 2012, there was a rat infestation in the kitchen. Miss Jones was busy on another project at the time and failed to deal with it promptly. In June, following a routine local authority health and safety inspection, "Cod & Chips" was closed down on public health grounds. By the time Miss Jones turned her attention to the problem, it was too late. It took her until September to bring it under control. By the time the business re-opened, the Olympic Games had finished. The turnover of "Cod & chips" in 2012 was £100,000. Miss Jones wishes to bring proceedings against Mr Smith.

Scenario 2

It is now January 2013. The turnover of Cod & Chips in 2012 was £200,000. However, shortly after the agreement was signed, Roman ruins were discovered at the proposed site in Stratford. Construction ceased immediately. The Olympic Delivery Authority decided that the Games had to be held in other parts of the UK, and, accordingly, the Stratford site was abandoned. Miss Jones wishes to bring proceedings against Mr Smith.