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But the purchase price has been apportioned: The impact of price apportionment in business purchase agreements on potential damages claims

Apportionment clauses

Apportionment clauses are frequently used in business purchase agreements (whether formulated as share purchase agreements or asset purchase agreements). These clauses allocate parts of the overall agreed purchase price to different parts of the business such as (i) land and buildings; (ii) trade fixtures and fittings; (iii) goodwill: and (iv) other separately identifiable intangible assets.

The apportionment is largely done for tax purposes but what about its effect on a damages claim? For example, if the purchaser has a claim that only relates to one part of the overall business (for which a specific value has been agreed), will that agreed value affect what can be recovered?

This article will briefly look at three key considerations: (i) the terms of the contract; (ii) the state of the current case law; and (iii) the application of an illegality defence.

Terms of the contract

The terms of the specific contract will have a significant impact on the position. For example, the terms themselves may expressly specify what effect the apportionment may have on a damages claim. Many agreements include provisions to the effect that the purchase of the various assets comprised in the business are interdependent and/or that the apportionment will not limit the purchaser's remedies. However, others do not.

The courts' approach

In the absence of a specific provision stating that the apportionment will not affect the purchaser's remedies, how have the courts approached the matter?

Surprisingly few cases that have dealt with the point. However, those that there are point to a holistic rather than forensic approach in the context of damages. Two key cases are:

1. ***Saunders v Edwards*** [1987] 1 WLR 1116 – This was a case arising out of purchase of a flat, where £5,000 of the £45,000 purchase price was allocated to chattels (which were plainly not worth that much). The claim was in misrepresentation but when assessing damages on the basis of the diminution in value, the court used the overall figure of £45,000 as the starting point rather than the £40,000 allocated in respect of the flat itself. Part of the reasoning for this was that because the claimant was relying on misrepresentation rather than a breach of warranty claim, it was not seeking to rely upon the terms of the agreement and so there was nothing inconsistent with challenging the apportionment of the purchase price.

2. ***Dhaliwal v Hussain*** [2017] EWHC 2655 (Ch) – A much more recent case arising out of the purchase of a dental practice business and premises. Again, there was an apportionment of value between the premises, the goodwill of the business and equipment (though none were for nominal value). The claims brought were in misrepresentation but also breach of warranty. When considering the issue of the apportionment when assessing damages for misrepresentation, HHJ David Cooke stated at [124]:

"I accept Mr Oughton's submissions that it is for the claimant to prove loss and that in a case such as this where a business and premises are acquired together for a combined price, the 'value acquired' is properly considered as the combined value of all the assets. Thus in principle it may not be appropriate to look only at the value of goodwill for instance, and assess loss as the difference between the consideration apportioned to the goodwill and the value of the asset as if it could be and had been assessed separately at the time. Accordingly, if it were shown that the property and/or the tangible assets were worth more than their stated prices, that excess would in effect be set against any overpayment for goodwill."

When considering the damages in respect of a breach of warranty claim, the judge stated at [154]:

"Neither counsel made any case that damages assessed for the breach of warranty claim would be different in amount from those for misrepresentation. The principle of assessment of primary loss differs in that the object is to place the claimant in the position she would be in if there had been no breach of contract, ie if the warranty were true. The measure of loss is the difference between the value the business would have had if the warranty were true on the one hand and its value given the actual circumstances on the other. However, as in so many cases, it is not contended that the business would have been worth more than the price actually paid, so the result is the same as that under the tortious measure."

Illegality?

In both the above cases, the defendant seller sought to run an illegality defence on the basis that the apportionments of the purchase price were done in such a way to avoid tax.

In ***Saunders***, the court rejected the argument on the basis that it could not apply to a misrepresentation claim but the judge strongly indicated that it would apply to a contractual claim for breach of warranty. Those comments are obiter and now need to be read in the light of the Supreme Court's guidance on illegality in ***Patel v Mirza*** [2016] UKSC 42.

In ***Dhaliwal***, the judge expressed some doubt about the application of an illegality defence in the circumstances.

However, he did not have to make a finding on the principle because he found that the argument failed on the facts.

Ultimately, it would seem that an illegality defence may now be much more challenging to run.

Conclusion

In summary, a price apportionment clause will not automatically limit a damages claim. The cases that there are indicate that the courts will take a common-sense approach and look at the reality of the purchase as a whole. However, these cases are only first instance decisions and so there may well be scope for further consideration by an appeal court.

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