



JONES DAY  
**COMMENTARY**

## APPOINTING AN INDEPENDENT VALUER: HOW A DISSENTIENT PARTY COULD FRUSTRATE EXPERT DETERMINATION PROVISIONS

The Court of Appeal has recently held that the process of appointing an independent accountant to value shares under the mandatory transfer provisions of a company's articles of association required the express agreement between the relevant shareholder, the company and the accountant regarding the terms of the accountant's appointment. In the absence of terms agreed by *all* those parties, the accountant was not validly appointed for the purpose of resolving the disputed value of the shares in question, effectively allowing the dissentient party to frustrate the resolution process.

Whilst this case is of particular importance to private equity investors (as mandatory transfer provisions are most commonly used in their investment documentation), it has far-reaching consequences for all commercial agreements where parties agree to a third party being appointed to resolve an issue in dispute.

In light of this decision, standard documents containing such provisions should be reviewed and amended accordingly and legal advice should be taken before expert determination processes are begun pursuant to existing arrangements.

### FACTS OF CASE

In *Cream Holdings & Ors v Stuart Davenport* [2008] EWCA Civ 1363, the respondent, Mr Davenport, was removed as the director of a company, thereby triggering the mandatory share transfer and valuation provisions in the company's articles. The articles contained typical provisions for the sale price of the director's shares to be the fair value agreed between him and the company or, failing agreement, the fair value determined by an independent accountant. The independent accountant was to be chosen by the director and the board or, failing their agreement on such appointment, by the President of the Institute of Chartered Accountants.

The parties failed to agree on the sale price, but did agree on the identity of a firm of accountants to act as the independent accountant and determine the fair value of the shares under the articles. Although the director agreed to the identity of the firm, the company alone signed an engagement letter with the firm of accountants; the director never signed the engagement letter and reserved his position concerning the firm's appointment.

The accountants determined the fair value of the shares and the director sought a declaration that the valuation was not binding on him, as there had been no agreement on the terms of the firm's appointment.

## COURT'S DECISION

The Court held that the accountant's role was to produce an expert valuation of the shares held by the director, who was then compelled to offer them for sale to the other shareholders at that valuation. The accountant also had the power to determine who would pay the costs of the valuation exercise and lay down the terms, such as limitation of liability, on which it would be prepared to act. As a result, on the company's appeal against the decision of the court at first instance, the Court of Appeal held that it would be "very surprising" if the firm of accountants could become the independent accountant under the articles solely as a result of nomination by the parties and without any agreement by both parties and the firm of accountants on the terms of their engagement.

The Court viewed the constituting of the independent accountant for these purposes as a process, rather than a single event such as its nomination. It held that the process was not complete unless and until all parties and the accountant had reached agreement on the terms of engagement: "Agreement between all concerned is what is required". The director's indication of his willingness to accept the identity of the firm of accountants was insufficient to constitute an agreement on its appointment. A firm which agreed to act on the instructions of one of the parties would not be acting as the independent accountant, and its determination of fair value of the shares would not therefore be binding on the director.

## CONSEQUENCES FOR MANDATORY TRANSFER PROVISIONS

The decision in *Cream Holdings* is important when considering articles of association typically used in private equity transactions. It suggests that a manager shareholder may be able to frustrate mandatory transfer provisions which customarily apply upon leaving a company (and so avoid having to sell his shares) by simply refusing to sign the third party valuer's engagement letter, even if the manager shareholder has agreed to the identity of the valuer. Simple inaction by such a shareholder can therefore potentially render mandatory transfer provisions ineffective.

Whilst the judge was critical of the drafting of the relevant provisions in this case, substantially similar wording to that considered by the court is often seen in practice. Hence, this case may have relevance for many existing arrangements.

## ENHANCING MANDATORY TRANSFER PROVISIONS

A clear distinction between the nomination of an independent accountant (which can be carried out by agreement between all relevant parties or by a third party, such as the President of the Institute of Chartered Accountants) and the appointment of an independent accountant (including the agreement of the accountant's terms of engagement) should be made in mandatory transfer provisions. A precise mechanism for agreeing to the appointment of the independent accountant should be set out and the drafting should allow all parties affected by the accountant's fair value determination to sign the expert's terms of engagement.

In addition, the provisions should allow the company or other appropriate interested party, such as the investors, unilaterally (as an attorney or agent of the other party(ies)) to agree to the terms of engagement with the independent accountant. In the absence of all relevant parties signing the expert's terms of engagement personally, an appointment made pursuant to such express authority may help to improve the prospects of an expert's determination being binding.

## WIDER IMPLICATIONS FOR ALL COMMERCIAL AGREEMENTS

The typical wording on determination of a share valuation by an independent accountant used in articles of association with mandatory share transfer provisions is similar to that used in a wide range of commercial agreements under which disputes are to be referred to a third party expert for determination. The contentious nature of the circumstances in which an expert determination is typically required means that great care should now be taken to ensure that all commercial agreements adopt similar nomination and appointment provisions to those mentioned above in order to prevent, so far as possible, a recalcitrant party from frustrating an expert determination process by simply refusing jointly to engage the agreed expert.

## REFERRING DISPUTES OR VALUATIONS TO EXPERTS UNDER EXISTING AGREEMENTS

In light of this case, great care should be taken over the process by which third party experts are appointed to determine disputes under appointment provisions which do not accommodate the recommendations mentioned above. Legal advice should be taken in advance to mitigate (insofar as possible) the risks of a party being able to frustrate the expert determination process once it has been commenced.

## EXERCISING RIGHTS UNDER EXPERT DETERMINATION PROVISIONS

In any case (that is to say, whenever exercising rights under any expert determination provisions, irrespective of whether they take into account such recommendations), to avoid there being any prospect that a party could challenge the effectiveness of an expert's determination, all parties to the dispute should sign the expert's terms of engagement.

If this is not possible and a party wishes to rely on specific contractual rights to appoint an expert unilaterally, it may be appropriate to consider seeking a declaration from court at the time of the expert's appointment that such expert's determination will be binding on all relevant parties. This will avoid the prospect of a later claim from a dissentient party on the grounds that the expert's appointment was defective. Whether a court declaration is appropriate will depend on the precise terms of the relevant provisions and any developments in case law following *Cream Holdings*.

## LAWYER CONTACTS

If you would like further advice or assistance, please contact your principal Firm representative or one of the lawyers listed below. General email messages may be sent using our "Contact Us" form, which can be found at [www.jonesday.com](http://www.jonesday.com).

### James Goold

Partner

+44 (0)20 7039 5244

[jegoold@jonesday.com](mailto:jegoold@jonesday.com)

### Anna Cartwright

Associate

+44 (0)20 7039 5290

[acartwright@jonesday.com](mailto:acartwright@jonesday.com)