"HOWLERS" AND THE MEANING OF "MANIFEST ERROR"

ENGLISH COURT CLARIFIES GROUNDS FOR CHALLENGE TO EXPERT DETERMINATIONS

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When negotiating transaction documents, dispute resolution provisions will often receive less attention than they should. Even when these provisions are negotiated, parties' concerns are often limited to how any future disputes should be finally resolved (for example, by court proceedings or arbitration), what the governing law should be, and what, if any, steps should be taken before any dispute resolution process is commenced (for example, if negotiation or mediation should be compulsory before legal proceedings are commenced). Expert determination is one form of dispute resolution that often goes overlooked in this context, despite its (a) potential as a quick and cost-effective dispute resolution mechanism and (b) suitability where the subject matter is specialised or technical in nature or a valuation is required. Another key advantage is that an expert's decision is difficult to challenge. English courts are reluctant to depart from what has been expressly agreed between the parties, including the chosen form and procedure for dispute resolution. This was highlighted in a recent decision of the English High Court in *Flowgroup Plc v Co-operative Energy Ltd*.[1]

Background

The claimant, Flowgroup PLC (Flowgroup), was the seller under an acquisition agreement concerning the allotted and issued share capital of Flow Energy Limited (Target), a gas and electricity supply company (the Acquisition Agreement). A dispute arose regarding the working capital adjustment to be applied. The Acquisition Agreement provided that any such dispute would be determined by expert determination. The parties appointed Ms. Maggie Stilwell, a partner of Ernst & Young LLP (the Expert), to resolve the dispute. The Expert produced a report and a determination which was favourable to the buyer, and defendant to the action that followed, Co-operative Energy Ltd (Co-operative). To challenge the decision, Flowgroup sought to rely on the following exception contained in the expert determination clause in the Acquisition Agreement, and which is a common feature of expert determination clauses: “The Expert's written decision on the matters referred to him will be final and binding *in the absence of manifest error* (in which case the Expert's written decision will be returned to the Expert for correction) or fraud.”[2]

In deciding Flowgroup's challenge, the High Court was required to consider (1) what, in general terms, did the words “manifest error” mean and (2) how should the “manifest error” exception be applied where the expert determination itself involved a question of contractual interpretation?

What Constitutes a “Manifest Error”?

It was undisputed that a “manifest error” is one which must be “obvious or easily demonstrable without extensive investigation” (per Lord Justice Jackson in *Amey Birmingham Highways Ltd v Birmingham City Council*[3]). But, the parties disagreed on what the words in *Amey* meant.

The seller, Flowgroup, contended the words denoted a “visibility” test, requiring that, in order to be a “manifest error,” the error must be demonstrable on the face of the record (i.e., when set against the correct answer). Co-operative contended more was required; the Expert needed to have made a “howler.” The Court held in favour of Co-operative; it found that a “manifest error” must be more than just a wrong answer or else there would be no real filter on the scope for challenge, and the English Courts would simply become an alternative forum for dissatisfied parties. The Court was persuaded to adopt the “definition” for “manifest error” proposed, in obiter, by Lord Justice Simon Brown in *Veba Oil Supply & Trading Gmbh v Petrotrade Inc*[4], which provided that “manifest errors” are “oversights and blunders so obvious and obviously capable of affecting the determination as to admit of no difference of opinion.”

The High Court reasoned that the test in *Veba Oil* was not inconsistent with the test in *Amey*, had not been disapproved (and, indeed, had been applied in other first instance decisions), and aligned with the academic materials it had been asked to consider. The *Veba Oil* test struck a balance of giving effect to the parties' express agreement (namely, to be bound by the Expert's decision) and allowing recourse to the Court, but only in “necessarily confined circumstances.”

“Manifest Error” and Contractual Interpretation

Flowgroup's second contention was that any failure by the Expert to properly construe the Acquisition Agreement would have to constitute a “manifest error” because, as a matter of English law, there is only one “correct” interpretation of a contract. The Court rejected that argument too. It reasoned that, in each case, the correct approach will necessarily turn on the terms and scope of the Expert's engagement. If the Expert has been engaged to determine matters of contractual interpretation, then the Court said there should be no reason why any challenge to the Expert's decision would not need to satisfy the “manifest error” test articulated above. The Court discussed a separate situation where the Expert has been engaged to make a decision in accordance with defined principles but has acted upon what, in the Court's view, is the wrong meaning of those principles. It said the English courts might interfere in the Expert's decision in that scenario if the Expert had gone “outside the limits of [their] decision making authority.”[5] But, in either case, the terms and scope of the Expert's engagement would be determinative.

The Court ultimately found that the Expert's engagement was broad and permitted her to determine issues of contractual interpretation, where necessary, to resolve the matters in dispute (in this case, how the terms of the Acquisition Agreement should be applied).

Comment

Expert determination can be an attractive form of binding dispute resolution where the dispute is unlikely to be factually intensive or legally complex. It follows that expert determination clauses commonly appear in commercial leases (to resolve disputes over service charges or rent reviews) and sale of business and share agreements (to determine the value of shares in a private company on a shareholder's exit or disputes over completion accounts). There are disadvantages to using expert determination clauses too. In particular, an expert determination is not enforceable in the same way as a court judgment or arbitral award, nor is it recognised or enforceable under international law. Where an unsuccessful party is non-compliant, it may be necessary to bring a new action to

enforce the Expert's decision. Depending on the jurisdiction, some of the extra cost and delay in doing so might be mitigated (for example, in England, a party may be able to expedite the process by relying on the summary judgment procedure under CPR 24). However, these enforceability issues can be particularly unattractive, especially where the dispute is likely to gain an international character.

If an expert determination clause may be appropriate, then parties should anticipate the particular legal, factual, or technical question(s), or a combination thereof, that they might ask an expert to determine and consider recording them in the transaction document to the extent possible. One might use an expert determination clause for some specifically carved-out aspects of a transaction agreement in conjunction with an otherwise applicable arbitration or court proceedings provision. In doing so, care should be taken to make clear the scope of each dispute resolution provision. The parties will, of course, ultimately set the terms of the Expert's engagement in the terms of reference; however, that negotiation is inevitably made all the more difficult once a dispute has already arisen.

The *Flowgroup* decision highlights some pitfalls to keep front of mind when using expert determination clauses. Unlike in arbitration and litigation, there are no “back up” rules of procedure or process in expert determination. Certainly, so far as English law is concerned, the law in the area is less developed. There are limited grounds to challenge an expert's decision, but those grounds are mostly dependent on the express wording of the dispute resolution provision and the Expert's terms of reference. Each must be carefully drafted, and the scope of the Expert's engagement should be clearly defined. Taking these precautions should protect the speed and certainty, which is usually associated with expert determination, unless, of course, your Expert makes a “howler”!

FOOTNOTES

[1] [2021] EWHC 344 (Comm).

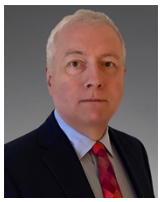
[2] Id, at [7] (emphasis added).

[3] [2018] EWCA Civ 264, [83]–[87].

[4] [2001] EWCA Civ 1832.

[5] [2021] EWHC 344 (Comm), [27].

KEY CONTACTS



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