EXPERT DETERMINATIONS –WHEN MAY THEY BE IMPLUGNED?

INTRODUCTION

1. This paper will focus upon some practical issues that arise in relation to the use of an expert to make a determination. It is hoped that the matters which are identified will assist in avoiding pitfalls that may be overcome in drafting an agreement to submit a dispute that may arise under it for expert determination and also to identify the factors which circumscribe court action which might arise as a result of such a determination. The matters to be looked at in this paper are:

A). What is an Expert Determination?
B). Basis of Impugning an Expert Determination for Error.
C). Failure to Comply with Procedural Fairness.
D). Refusal of Discretionary Remedy.

2. Many of the issues raised in this paper have recently been considered by her Honor Ward J in John Nelson Developments Pty Limited v. Focus National Developments Pty Limited 5 March 2010[2010]NSWSC 150 ("JND v. Focus").

3. The case involved a dispute between the parties to a failed property development joint venture in Port Macquarie. The First Defendant/Cross Claimant, Focus, was seeking restitution in respect of contributions it made to the joint venture project which failed without fault of either party and in circumstances where the Joint Venture Agreement did not contemplate the events which had occurred. The parties pursuant to their Joint Venture Agreement referred various aspects of dispute to Expert Determination. The Joint Venture Agreement between the parties provided:

(i) Any dispute relating to **legal issues** will be determined by a practicing barrister or a solicitor acting as an expert; and
(ii) Any dispute relating to **financial or accountancy issues** will be determined by an independent chartered accountant acting as an expert.

4. The dispute in relation to legal issues was referred to a Mr. Graham Molloy, solicitor and the financial issues were referred to a Mr. Raymond Tolcher. Despite these two expert determinations, the parties still needed to have recourse to the Supreme Court to obtain a determination of the ultimate issues arising between then as a result of which Focus obtained the relief it sought. Her Honor found:

312….., Mr. Molloy declined to accept appointment as an expert to determine the question of legal liability as to who owed what to whom; he simply construed various clauses of the agreement and did so without addressing (or being in his retainer agreement asked to address) Focus' claim for restitution of payments made by it by way of contribution to the project. Mr. Tolcher, whose determination I have found not to be binding on the parties, in any event, did no more than quantify the liability that he assumed had arisen in accordance with the interpretation of the contract by Mr. Molloy. There has at no time been a determination as to the legal liability of Focus/ Mr. Adamo to JND as a result of the expert determination process or otherwise, nor does their

agreement to abide by an expert determination of the dispute as to legal liability assist JND (since that particular dispute was not referred to anyone).

A. WHAT IS AN EXPERT DETERMINATION?

5. As Einstein J observed in The Heart Research Institute Limited and Anor v. Psiron Limited[1]:

[16] As the plaintiffs point out, in practice, Expert Determination is a process where an independent Expert decides an issues or issues between the parties. The disputants agree beforehand whether or not they will be bound by the decisions of the Expert. Expert Determination provides an informal, speedy and effective way of resolving disputes, particularly disputes which are of a specific technical character or specialized kind.

[17] Unlike arbitration, Expert Determination is not governed by legislation; the adoption of Expert Determination is a consensual process by which the parties agree to take defined steps in resolving disputes. I accept that Expert Determination clauses have become commonplace, particularly in the construction industry, and frequently incorporate terms by reference to standards such as the rules laid down by the Institute of Engineers Australia or model agreements such as that proposed by Sir Laurence Street in 1992. Although the precise terms of these rules and guidelines may vary, they have in common that they provide a contractual process by which Expert Determination is conducted.

6. Typically, many commercial agreements today are drafted with clauses to the following effect:

6.1 If any dispute arises out of this agreement ("the dispute"), a party to this agreement must not commence any court or arbitration proceedings unless the parties to the dispute have complied with certain stipulated paragraphs except where a party seeks urgent interlocutory relief.

6.2 Notice of dispute provisions.

6.3 Dispute resolution provisions including mediation.

6.4 Referral of disputes to an expert for determination. For example in the case of a valuation disputes:

6.4.1 *"Any dispute relating to valuation issues will be determined by an independent Valuer acting as an expert and not as an arbitrator to be selected by agreement of the parties or, if they cannot agree, then nominated by the President for the time being of ..."*

6.4.2 *"The decision of the expert shall be final and binding on the parties."*

6.5 The expert making the decision will act as an expert and not as an arbitrator.

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[1] [2002] NSWSC 646 (25 July 2002)

7. As will be seen, an Expert Determination is an alternative to arbitration. If a disputed matter under the agreement proceeds to arbitration, it will be governed by the *The Commercial Arbitration Act* 1984 *New South Wales*. S38 of that Act provides inter alia that subject to leave of the Supreme Court)and the restrictive conditions for obtaining such leave), an appeal shall lie to the Supreme Court on any question of law arising out of an arbitration award. Whilst such matters relating to arbitration are beyond the scope of this paper, it ought to be note that an Expert Determination is not so governed. There is no prescribed basis for review of an Expert Determination.

8. In general terms, an Expert Determination will only be reviewable if it is beyond the parties' contract.

9. Moreover, it has been accepted that Expert Determination clauses in agreements are not void for public policy in seeking to oust the jurisdiction of the Courts.
10. Rolfe J in Fletcher Construction v. MPN Group Pty Limited[2] concluded of an Expert Determination clause:

"There is nothing unusual about such a provision and parties are held to their bargain if they agree to such a clause.

Nor is there anything unusual about the clause providing that the expert's decision shall be "final and binding" or "conclusive" and provision such as that do not oust the jurisdiction of the Court. The effect of the clause is to make the decision of the expert final and binding provided the matters referred to him are ones which the agreement contemplates.

B. BASIS OF IMPUGNING AN EXPERT DETERMINATION FOR ERROR
11. In JND v. Focus, Ward J reviewed the authorities succinctly as follows:

197 In Legal & General Life of Australia Limited v A Hudson Pty Limited (1985) 1 NSWLR 314, the Court of Appeal considered the circumstances in which an expert determination could be rendered ineffective by reference to an error on the part of the expert.

198 At first instance ([1984] 1 NSWLR 1), Waddell J had drawn a distinction between an error in the application of valuation principle or a mistake in calculation, neither of which would affect the binding nature of the valuation, and an error resulting in the valuation not being in conformity with the contract, which his Honor considered would render it ineffective to bind the parties.

199 On appeal, his Honor's decision was reversed, Mahoney and McHugh JJA holding that his Honor had erred in fining that the valuer had made the error in question (said to have been an error in taking a mezzanine floor area into account in determining the rental value of the premises); Priestley JA reaching the same result on the basis that the plaintiff

[2] 14 July 1997 Unreported

had not discharged the onus of proving that the valuer had taken the mezzanine area into account.

200 McHugh JA, having examined the relevant authorities, distilled from then [at 335-6], the following as to the circumstances in which mistake on the art of an expert would justify the setting aside of the expert's determination:

the question whether an expert determination is binding depends in the first instance on the terms of the contract, express or implied;

a determination obtained by fraud or collusion can usually be disregarded (for almost certainly it would be the case that in such a case there had been no valuation in accordance with the terms of the contracts; it being easy to imply a term that the determination must be made honestly and impartially);

it will be difficult, and usually impossible, to imply a term that the determination can be set aside on the basis of mistake or because it is unreasonable, since, by referring the decision to an expert on the basis that the decision will be final and binding, the parties will be said to have agreed to accept the expert's honest and impartial decision, relying on the expert's skill and judgment, and have agreed to be bound thereby;

the critical question in cases where it is alleged that the expert has made a mistake is whether the determination wad made in accordance with the terms of the contract –if the mistake is of a kind which shows that the determination is not in accordance with the contract (such as where a valuer values the wrong premises), then the determination may be rendered ineffective; if the mistake is as to the application of the expert's judgment or as to what the expert has or has not taken into account, this is not a matter which affects the binding nature of the determination.(my emphasis)

201 As his Honor, much later when speaking extra-judicially in an address to the Chartered Institute of Arbitrators (Australia) Limited on 30 April 2007[3], noted, the statements of principle he enunciated in Legal & General have been recognized as well settle (referring to the judgment of Palmer J in Kanivah Holding Pty Limited v Holdsworth Properties Pty limited [2001] NSWSC 405, [at 48]). More recently, in AGL Victoria Pty limited v SPI Networks (Gas) Pty Limited [2006] VSCA 173, the Court of Appeal in Victoria held that the principles outlined by McHugh JA in Legal & General remain applicable.

202 Mr. Reuben relied upon what was said by Mason P, with whom Priestley JA agreed, in Holt v Cox (1997) 23 ASCR 590 at p597, namely that:

A close reading of McHugh JA's judgment in Legal & General indicates that his Honor was not propounding the view that a valuation will stand regardless of error. Rather, he was making the point that mistake is not itself a ground of vitiation: see also Wamo Pty Limited v Jewel Food Stores Pty Limited (1983) ANZ Conv R 50.

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[3] Address to the Chartered Institute of Arbitrators (Australia) Limited on 30 April 2007.

203 There, Mason P said that the critical question was whether the mistake was such as to render the valuation one which was not in accordance with the terms of the contract. In the AGL case, Nettle JA noted [at 51] that a mistake may "be of such a nature that the resultant determination is beyond the realm of contractual contemplation – *beyond anything which the parties may be supposed to have intended to be final and binding* – and therefore susceptible to review". (my emphasis)

204 In Holt v Cox, at first instance ((1994) 15 ACSR 313), Santow J held that where there was a direction to the expert (in that case the auditor) to determine the fair price for shares compulsorily acquired, the expert was entitled to adopt his or her own methodology for so doing and that any mistakes in the methodology adopted by the expert were "mistakes in the course of doing what the contract required". It was a matter of his or her expert opinion, it was appropriate to do so (at 33). There, however, his Honor observed that a valuation made contrary to the principles of valuation might not produce what was contractually demanded in that case (a 'fair value').

12. In Holt v Cox (1997) 23 ACSR 590, the Court of Appeal by Mason P and Priestley JA (Cole JA dissenting) held in dismissing the Appeal that the auditor erred in his handling of certain issues relating to valuation and the errors exposed prevented the ensuing determination being the "fair price" required by the parties agreement.[4]

Error of Law

13. There do not seem to be any clear decisions in Australia where an expert has misdirected himself on a point of law and makes a determination on the basis of an incorrect interpretation of the legal position.

14. In Fermentation Industries (Aust) Pty Limited v. Burns Phil & Co unreported Rolfe J NSWSC 12 February 1998; BC9800135 (reversed on appeal [2000] NSWCA 71; BC200002628 but not on this point) a distinction was drawn between an error in the exercise of discretion arrived at by a valuer and one where the expert arrived at a value that was not the current annual open market rental value as required under the contract. In the latter case Rolfe J expressed some difficulty in adopting the proposition that one could pre-suppose that notwithstanding that a valuation was made negligently, or in mistaken application of principles of valuation, it will nonetheless be made in accordance with the terms of the contract.

15. Certainly, in England it has been held that if there is an error on the question of constriction of the relevant agreement and therefore on a question of law, if the expert misinterpreted the relevant phrases and makes a determination on the basis of an incorrect interpretation, he does not do what he was asked to do – Mercury Communications Limited v. Director General of Telecommuniations [1996] 1 WLR 48 (HL) at 58.

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[4] Per Mason P at 603-605

16. In JND v. Focus, Ward J said of this proposition as a basis for impugning an Expert Determination in that case:
229 Reliance was placed by Mr. Reuben on what was said in Mercury Communications Limited v Director General of Telecommunications [1996] 1 WLR 48 at 58, namely that if there is an error on the question of the construction of the relevant agreement, and the expert makes a determination on the basis of an incorrect interpretation, then the expert doe not do what he or she was asked to do. There, however, the issue for determination was not the very issue in respect of which the error of law was said to have been made.

230 Here, Mr. Molloy was asked, as a legal expert, to construe certain clauses of the JVA. If he made an error of law in that regard (by disregarding words or by misconstruing phrases in the agreement as is submitted), this surely is an error of judgment of the kind of which the parties should be taken to have assumed the risk. His skill and judgment in constructing provisions of a contract are the very matters on which the parties have placed reliance and, if he has erred in that regard, that is a risk the parties must be taken to have accepted. Therefore, I do not consider the reasoning in Mercury to be of assistance.

17. Applicable legal principles relating to the setting aside of an expert determination may be found in AGL Victoria Pty Limited v. SPI Networks (Gas) Pty Limited [2006] VSCA 173; BC 2006 06803. Those principles may be summarized as follows:

17.1 The test propounded by McHugh JA in Legal & General Life of Aust. Limited v. A Hudson Pty Limited still applies. Where parties to a contract have agreed that an expert determination shall be final and binding, it is ordinarily not open to a Court to review the determination on the grounds of mistake unless the mistake is such as to show that the determination has not been carried out in accordance with the contract or, to put it another way, that the expert has not performed the task entrusted to the expert by the contract Holt v. Cox (AGL [43]).

17.2 Whether it is open to review an expert determination on the ground of errors is in the first place to be decided according to whether the determination answers the contractual description of what the expert was required to determine (AGL [51]).

17.3 A mistake may still be of such a nature that the resultant determination is beyond the realm of contractual contemplation – beyond anything which the parties may be supposed to have intended to be final and bindings and therefore susceptible to review (Holt v Cox). The situation is analogous to that which faces a Court in cases of judicial review of administrative error. There are some administrative mistakes which amount to jurisdictional error, and so expose a decision to judicial review. Those appointed under contracts to make a determination may make errors which are beyond the area of tolerance which it is to be supposed the contract had in view (AGL [51] & [52]).

17.4 The question in each case is what the parties should be presumed to have intended, and that is to be determined objectively from the terms of the contract bearing in mind the context in which it was created (AGL [54]).

17.5 The question is to be decided according to whether the determination complies with the contract. In respect of commercial agreements, their terms must be construed against the matrix of facts which underpins those arrangements and as the Court would suppose that honest business men would understand the words they have actually used with reference to their subject matter and the surrounding circumstances (AGL [77] & [80]).

18. In AGL Nettle JA in the Victoria Court of Appeal (with whom Maxwell P and Bongiorno AJA agreed), stated that he was unable to accept that honest businessmen would mean to bind the parties to an agreement by a Determination of Reconciliation Amount base upon an error as to the volume of gas extracted from the system with consequences amounting possibly to millions of dollars. In his Honor's view "honest business would surely say that such a determination was not in accordance with their agreement".[5] Accordingly, the determination in that case was reviewable for mistake of fact.

19. By looking at the principles expressed above, it would seem that some of the pitfalls in relation to the Expert Determination process can be avoided by:

19.1 Having a clear scope of matters to be decided by the expert.

19.2 Identification of the matters in dispute which are to be decided.

19.3 Providing in the agreement whether the expert shall make the Expert's Determination on the matters in dispute in accordance with the law.

19.4 Providing in the agreement whether the expert shall make the determination of the matters in dispute (only) on the basis of information received from the parties and (subject to the requirements of procedural fairness), the expert's own expertise.

19.5 Whether the expert is required to afford the parties' procedural fairness and the procedures that the expert and the parties will follow in that event.

C. FAILURE TO COMPLY WITH PRODEDURAL FAIRNESS

20. Expert determinations contain an implied term that the expert will determine the relevant issue honestly and impartially; *Baber v. Kenwood Manufacturing Co Limited* [1978] 1 Lloyd's rep.175 at 181; *Legal & General Life of Australia v. A. Hudson Pty Limited* [1985] NSWLR 314 at 335 but not that an expert must afford the parties natural justice.

21. In JND v. Focus, Ward J said of this issue
Duty to accord procedural fairness?

[5] Per Nettle J para [80]

206 As to whether the expert is under a duty to accord procedural fairness, in the absence of express agreement this depends on whether the task being carried out by the expert is in the nature of a judicial enquiry. In his address to the Institute of Arbitrators, the Hon Michael McHugh AC[6] observed that the fact that a determination was being carried out as an expert and not as an arbitrator pointed against the rules of natural justice being generally applicable to expert determinations but considered that there was a strong case for saying that where the expert was required to receive submission from parties then the rules of natural justice should apply (on the basis that the expert determination was there analogous to a quasi-judicial enquiry).

207 In Enron Australia Finance Pty Limited (in liq) v Integral Energy Australia [2002] NSWSC 753, Einstein J noted at [111-113] that:

It is plain that when one is examining the conduct of a judicial or quasi-judicial hearing, there is an expectation of impartiality and adherence to procedural fairness (or what was formerly referred to as natural justice).

However, where what is involved falls outside the realm of judicial or quasi-judicial determination, the issue is whether the principle of procedural fairness can be or should be maintained...

It is of assistance to address this issue by first asking whether the ... task to be seen as that of an arbitrator, ie a quasi-judicial determination which will automatically invoke the principles or impartially, or whether the task is merely that of an expert, valuer or appraiser. (my emphasis)

208 This is consistent with the authorities referred to by the Hon Michael McHugh AC, in his 2007 address referred to above, commencing with *Re Carus-Wilson and Greene* (1886) 18 QBD 7, where the Court of Appeal in England (considering the question whether an umpire appointed to make a valuation in circumstances where the respective valuers appointed by each party had disagreed was an arbitrator, decided the issue by reference to whether the umpire was bound by the rules of natural justice) drew a distinction between the conduct of an arbitration (an enquiry of a judicial nature to be worked out in a judicial manner) and the appointment of a person to ascertain a matter, not for the purpose of settling a dispute but of preventing disputes (the latter such appointment, by inference, not being seen by the court as one for the carrying out an enquiry to be worked out in a judicial manner); and *Capricorn inks Pty Limited v Lawter International (Austalasia) Pty Limited* [1989] 1 Qd R 8, where McPherson J in the Supreme Court of Queensland at [15], contrasting an arbitration and an appraisement, said of the former that "generally what must be in contemplation is that there will be an 'inquiry in the nature of a judicial inquiry'" and where, on appeal, the Full Court was of the view that there was no right on the part of the parties to be heard where the relevant enquiry was being carried out by the accountants acting as experts not as arbitrators. Thomas J there noted that the arbitral function was to hear and resolve opposing contentions of the parties (as opposed to an appraisal or expert decision which typically

[6] Address to the Chartered Institute of Arbitrators (Australia) Limited on 30 April 2007.

would be made through specialist knowledge or skills, without any requirements or obligation of first hearing from the parties).

209 Mr. Reuben pointed out that in *Fletcher Construction Australia Limited v MPN Group Pty Limited* (unreported 14 July 1997), Rolfe J, after referring to and seemingly concurring with the decision of Cole J in *Triarno Pty Limited v Tridon Contractors Limited* NSWSC (unreported 22 July 1992) (where Cole J has held that if the parties had not agreed the procedure for the expert to follow it was then a matter for the expert and not the court to determine), added that:

In devising procedures the expert is no doubt obliged to ensure that he or she affords natural justice to both parties but, subject to that, he or she is to enter upon the determinative task as an expert and not as an arbitrator though without explaining the basis on which there was said to be no doubt as to an obligation to afford natural justice in that instance.

210 Here, the JVA was silent as to the procedure to be adopted by an expert in determining a dispute whether that be a dispute under clause 15.3.1 or 15.3.2. Absent agreement between the parties, in accordance with *Triarno*, the procedural requirements for the determination would therefore be a matter for the expert to determine.

217 I should also note that there seems to be no procedural unfairness in Mr. Tolcher having sought independently to inform himself of matters he considered relevant to the dispute from Mr. Molloy, having regard to what was said by Cole J in *Triarno*.

22. In *Carbotech-Australia Pty Limited v. Yates* [2008] NSWSC 540 at [39], Brereton J held that in the case of a Court appointed referee, a referee may, subject to nay directions of the Court, conduct proceedings and inform himself or herself in such manner as he or she thinks fit.

23. Likewise in JND v Focus, Ward J considered that the second expert Mr. Tolcher could communicate directly with the first (legal) expert, Mr. Molloy to inform himself of the legal parameters under which the parties were operating without compromising the validity of his determination.[7]

D. REFUSAL OF DISCRETIONARY REMEDY

24. The grant of a Decree of Specific performance is a discretionary remedy. Typically, a Plaintiff may in essence be seeking to enforce an alleged obligation of a Defendant arising after an Expert Determination.

25. In Parken v. Whitby 91823) Turn & R 366; 37 ER 1142, Sir Thomas Plummer, the Master of the Rolls, affirmed the right of the Court of Chancery to refuse specific performance of a contract if it thought that the sum fixed by a third party was erroneous. In the seminal case of *Collier v. Mason* (1858) 25 Beav 200; 53 ER 613, it was said by Sir John Romilly that the Court acts upon the principle laid down by Lord Eldon in

[7] Paras [280] & [281]

Emory v. Wayse (1803) Ves Jun 505; 31 ER 889, where the Court must act on a valuation unless there be proof of some mistake or some improper motive, such as if the valuer had valued something not included or had valued it on a wholly erroneous principle.

26. In JND v. Focus, Ward J noted:
205 However, relevantly, for present purposes, in *Legal & General*, McHugh JA noted (at p 336) the distinction between cases where a party sought an equitable remedy to enforce an agreement to abide by an expert determination (in which case reliance ona defence based on mistake could be made) and a case seeking a common law remedy (where a defence of mistake would only lie if the express or implied terms of the contract permitted). Hence, his Honor recognized that it would be open to a court in equity to decline to enforce an expert determination even thought it might be binding on the parties as a matter of contract between them.

27. In relation to declaratory relief, in JND v. Focus, Ward J noted:
300 As noted by Mr. Reuben, the grant of a declaration is a discretionary remedy (Mr. Reuben citing *Ainsworth v Criminal Justice Commission* (1992) 175 CLR 564 at 581-2). There, the High Court said that declaratory relief will not be granted if the question is hypothetical or the relief will produce no foreseeable consequences for the parties. Another ground for refusing declaratory relief, to which the authors of *Equity Doctrine & Remedies* (4th edn) R Meagher, D Heydon, M Leeming (2002) at [19-130] have adverted, is that no good purpose will be served by granting it citing *Rivers v Bondi Junction Waverley RSL Sub-Branch Limited* (1986) 5 NSWLR 362.

301 In relation to the Molloy determination, it was submitted that the court should refuse to exercise its discretion to grant a declaration where the conclusion reached in the determination is clearly wrong (if the Molloy determination is read as being restricted to the construction of particular clauses in isolation, rather than the operation of the contract as a whole in the circumstance which have arisen).

302 Declaring that the Molloy determination (as so limited) is binding on the parties would not amount to a finding that Mr. Molloy's construction of the contract is correct as a matter of law (simply that the parties has agreed to accept it as such) nor would it require the court to endorse what, on balance, I have found to be a incorrect application of the contract clauses in the particular circumstances of this case. Rather, it would simply acknowledge what the parties has agreed would be the case – that they would, as between themselves. Be bound by a determination made in good faith by an impartial expert (implicitly accepting that it might not accord with what a court would determine) insofar as such a construction might be relevant. To hold otherwise would, in my view, undermine the process of expert determination.

303 I understand the force of the comment by the Hon McHugh AC that there is a natural judicial reluctance to uphold a decision which is regarded as unreasonable (or, here, to declare binding a determination of the construction of the contract with which I respectfully disagree). However, I am conscious also of the fact that it is well accepted in the context of expert determinations that parties choosing this means of alternative

dispute resolution (whether for disputes involving legal or other issues) do so accepting that the expert may make errors of judgment or principle which will not be susceptible to review by the courts at a later stage.

304 Accordingly, I would have been prepared to make the declaration sough as to the binding nature of the Molloy determination as to the construction of the various clauses of the agreement but for my concern that to do so will confuse the real issue between the parties and that it will be of no real utility.

Conclusion

1. Whilst Expert Determination is seemingly a desirable method of Alternate Dispute Resolution, it contains many pitfalls which may be met along the way.
2. Problems can be avoided by close scrutiny in advance of the matters to be the subject of Expert Determination.
3. Defining by agreement, the matters to be decided by the expert, is of critical importance.
4. Guarding against a failure to accord procedural fairness or failure to make a determination according to law, can be dealt with by drafting appropriate safeguards in the parties' agreement either at its initial stages or the referral stage.
5. Careful consideration of the choice of expert and the drafting of the expert's terms of reference by a consultative process to identify the real matters that are going to resolve the dispute will make the process a much more effective means of alternate dispute resolution.

By Sam Reuben
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March 2010