

# Expert determination clauses

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While expert determination can no longer be regarded as the domain of single issue technical questions, it is not for every dispute. Whether expert determination, as a process, should be recommended over other forms of dispute resolution will depend on a variety of factors ranging from the subject matter of the potential dispute to the appetite of the parties to engage in the longer, more expensive and more rigorous processes of litigation and arbitration.

Where expert determination is used, the process should be appropriate for the issues to be determined, the clause needs to be enforceable and facilitate a procedure which is both practical and effective. These are the matters discussed in this guide.

## WHAT IS EXPERT DETERMINATION?

In practice, expert determination is a process where an independent expert decides an issue between the parties. The disputants agree beforehand whether or not they will be bound by the decision of the expert. It provides an informal, speedy and effective way of resolving disputes, particularly disputes which are of a specific technical character or specialised kind. 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. Expert determination clauses frequently incorporate terms by reference such as procedural rules laid down by various institutes. Although the precise terms of these rules and guidelines vary, they have in common that they provide a contractual process by which expert determination is conducted<sup>1</sup>.

<sup>1</sup> *The Heart Research Institute v Psiron* [2002] NSWSC 646 (25 July 2002) per Einstein J

## WHAT RESTRICTIONS ARE THERE ON THE TYPES OF DISPUTES WHICH CAN BE REFERRED TO EXPERT DETERMINATION?

Unless exclusive jurisdiction has been conferred by statute on a particular court or tribunal, there are few restrictions on the sorts of disputes that can be referred to expert determination.

Attempts have been made to invalidate expert determination clauses on public policy grounds on the basis that they amount to an attempt to oust the jurisdiction of the courts. These arguments rarely succeed. An expert determination clause is an agreement between the parties that the specified disputes shall be determined by an expert. 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 provisions 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<sup>2</sup>.

All disputes will entail issues which concern any one of, or a combination of, fact, law (including contractual interpretation) or technical issues. In principle, there is no reason why any of these issues or a combination of them could not be determined by an expert<sup>3</sup>.

## WHAT DISPUTES SHOULD BE REFERRED TO EXPERT DETERMINATION?

While a broad range of issues are capable of being referred to expert determination, considerable care needs to be exercised when deciding what disputes in any particular contractual setting "should" be referred to expert determination.

Difficulties may be encountered when factual issues are referred to experts particularly questions involving issues of credit – that is, who is to be believed. In the ordinary course, an expert does not have the ability to compel a witness to give evidence or test a witness through cross examination, nor does the expert have the power to compel the production of documents from third parties. In those circumstances, the expert can be placed in an impossible position when trying to determine the truth out of competing versions of the facts.

## THE SCOPE OF THE QUESTION TO BE DETERMINED

Considerable care is required when formulating the scope of the issue to be decided by the expert. The validity of an expert determination may be challenged where the expert is required to decide a technical question but, in so doing, it is necessary for the expert to form a view as to the correct contractual interpretation of the relevant clauses.

The ability to set aside an expert determination is dependent on whether or not the expert has carried out the task which he or she was contractually required to undertake. If the expert has carried out that task, the fact that errors were made or the expert took irrelevant matters into account does not render the determination challengeable. On the other hand, if the expert has not performed the task contractually conferred on him or her, but rather performed some different task, or carried out his or her task in a way not within the contractual contemplation of the parties, objectively ascertained, then the determination will be liable to be set aside<sup>4</sup>.

A distinction is to be drawn between matters involving discretion or opinion on the one hand and matters of objective fact. Matters of contractual interpretation are characterised as matters of objective fact because the objective analysis required by the process of contractual construction can only produce one meaning<sup>5</sup>.

The critical question is whether the parties agreed to be bound by the expert's determination both on the construction of the contract as well as on the matter involving discretion or opinion. If the expert determination clause is drafted such that the expert is required to answer a technical question but, in order to do so, the expert is required to undertake a contractual analysis or interpretation, then there is a risk that the determination may be set aside if the expert's contractual analysis is incorrect. It seems clear, however, that the parties are able to include drafting to ensure that any necessary decisions of contractual construction made in reaching the determination are final and binding.

<sup>2</sup> *Fletcher Construction Australia Ltd v MPN Group Pty Ltd* (Unreported, Supreme Court of NSW, Rolfe J, 14 July 1997)

<sup>3</sup> *Downer Engineering Power Pty Ltd v P&H Minepro Australasia Pty Ltd* [2007] NSWCA 318 (9 November 2007) [79].

<sup>4</sup> *Australian Vintage Ltd v Belvino Investments No 2 Pty Ltd* [2015] NSWCA 275 (11 September 2015) at 74 and 75. Also see *AGL Victoria Pty Ltd v SPI Networks (Gas) Pty Ltd* (2006) Aust Contract Reports 90-241 and *Shoalhaven City Council v Firedam Civil Engineering Pty Ltd* (2011) 244 CLR 305 [26]-[27].

<sup>5</sup> *Onesteel Manufacturing Pty Ltd v BlueScope Steel (AIS) Pty Ltd* [2013] NSWCA 27; 85 NSWLR 1 at [61].



While expanding the clause in this fashion might avoid the determination being set aside, the drafts person may need to consider whether this outcome is appropriate in any given circumstances. For example, should the parties be bound by an incorrect interpretation of the contract by a valuer tasked with the function of determining an accounting or valuation issue? The desire for a speedy and binding outcome needs to be weighed up against the risk of being bound by an incorrect contractual or legal finding with the losing party being dissatisfied with the outcome.

Assuming that the expert is not legally trained, a more practical approach may be to confer a right on the expert to obtain a legal opinion from a pre-agreed member of Senior Counsel or other appropriate senior lawyer. The effectiveness of such an approach may depend on whether the expert identifies the legal issue upon which the determination will be based prior to making the determination. Even if a legal opinion is sought, that may not overcome the issue because one or other of the parties may still not agree with the legal opinion.

Alternatively, the clause might provide for legal or contractual interpretation issues to be referred to a legally trained expert with other issues determined by an expert with the appropriate technical training or experience. The effectiveness of this approach may also depend on whether the parties identify the legal or contractual issue which needs to be determined before the technical issue can be addressed.

Consideration might also be given to the appointment of a senior lawyer as the expert who will make the determination relying on the submissions of the parties including expert reports from industry specialists. But this is looking more like a “papers only” arbitration which would seem to defeat the purpose of an expert determination where a person with particular technical expertise is chosen to bring those skills and expertise to bear in answering the question in issue.

## APPOINTMENT OF EXPERT

Most expert determination clauses require parties to seek to agree on the identity of the expert and if the parties cannot agree on the identity of the expert within a specified timeframe, either party may request a nominated third party such as the president of an industry body to appoint the expert.

A common mistake with appointment clauses is the inherent assumption that the institute or professional body is willing to make the appointment. What is overlooked is that some of these bodies regard the appointment of an expert as being outside their charter and will refuse to comply with requests to appoint experts. For example, the Institute of Chartered Accountants will only provide parties with a list of potentially suitable experts, from which the parties must still select the expert.

Where the institute or professional body is unwilling to make the appointment, a question arises as to whether the court will come to the aid of the parties to prevent the agreement from being rendered unenforceable. While courts endeavour, wherever possible, to give effect to parties’ agreements, the authorities in relation to this question are not easily reconciled.

Courts may appoint an expert if satisfied that the contractual machinery for the appointment is not an essential and indispensable part of the contractual bargain. The contractual machinery will be essential where the expert is appointed because of some particular quality or special knowledge on his or her part to which the parties attach particular importance. In this regard the nomination of a single valuer, such as a company’s auditor affords a possible example of contractual machinery which is essential and indispensable.<sup>6</sup> Adopting this approach, the courts may appoint an expert where the contractual machinery is merely a person to be appointed by a president or chairperson of a particular professional body who, for whatever reason, has declined to make the appointment.<sup>7</sup>

There is, however, a different line of authority suggesting that it is not open for a court to substitute its own machinery where the machinery nominated by the parties fails and that, in such circumstances, the clause is incomplete and unenforceable.<sup>8</sup>

In light of the conflicting authority, it may be prudent to include a clause which expressly provides that the parties will do all things reasonably necessary to cooperate in the selection of an alternative industry body to make the appointment where the named body fails or refuses to nominate an expert. Alternatively, a clause could be included (similar to the section which exists in the uniform commercial arbitration legislation<sup>9</sup>) to enable the court either to appoint an expert or substitute an alternate body to make the appointment in those circumstances.

<sup>6</sup> See *Sudbrook Trading Estate Ltd v Eggleton* [1983] 1 AC 444, 483-4.

<sup>7</sup> See *Bounty Systems Pty Ltd v Odyssey Gaming Services Pty Ltd* [2007] QSC 230 (31 August 2007) [61].

<sup>8</sup> *Van der Waal v Good Enough* [1983] 1 NSWLR 81 [93]. *Kinivan v Maoudis* [1988] ANZ ConvR 320, 321 *Agmon Investments Pty Ltd v Inglis* [2006] NSWSC 932 (11 September 2006) [18].

<sup>9</sup> See, for example, section 11(3) of the *Commercial Arbitration Act 2011* (Vic).

## PROCEDURE FOR DETERMINATION

The draftsman must decide whether or not to specify in the clause a procedure to be followed by the expert in carrying out the expert determination and, if so, what that procedure should require the expert to adhere to.

The absence of a procedure to be followed is unlikely to invalidate the expert determination clause. If the parties have not agreed the procedures to be followed upon an expert determination, that is not a void the court can fill and the procedure, in those circumstances is likely to be determined by the expert<sup>10</sup>.

If the decision is taken not to specify the procedure to be followed, then a number of consequences follow. Unless required to do so, the expert is not obliged to apply procedural fairness or the rules of natural justice<sup>11</sup> and he or she is not required to give reasons for the determination.<sup>12</sup> While specifying a procedure may not be essential to the validity of the clause, in all but the most highly technical disputes, it is prudent to include a procedure to be followed and reasons to be given.

One short hand way of providing for a procedure for the expert determination is to incorporate by reference into the clause the rules published by a dispute resolution body with the condition that they apply except to the extent they are inconsistent with the clause. For example, the Resolution Institute (formerly the Institute of Arbitrators and Mediators Australia) has published rules for expert determination which cover a variety of issues including procedural aspects of the determination, including such things as:

- the general duties of the parties to do all things reasonably necessary for the proper, expeditious and cost effective conduct of the process, including compliance by the parties with respect to any direction or ruling by the expert as to procedural or evidentiary matters;
- empowering the expert to make directions and rulings in relation to clarifying issues in dispute, the provision by the parties of submissions and evidentiary material;

- requiring the expert to act fairly and impartially as between the parties giving each party a reasonable opportunity of putting its case and dealing with that of the opposing party and a reasonable opportunity to make submissions on the conduct of the process;
- confidentiality and entering into appropriate confidentiality undertakings;
- the convening of a preliminary conference by the expert to plan and agree a timetable for the provision of submissions, documents and other evidentiary material;
- meetings between the parties, their representatives and/or experts individually engaged by the parties (including conclaves of the experts individually retained by the parties), whether or not such meetings are attended by the expert appointed to determine the dispute; and
- the timing of the determination and what it is to contain, including a statement of reasons in such form as the expert considers reasonably appropriate, having regard to the amount and the complexity of the dispute.

In the normal course, an expert will be appointed because he or she possesses a particular skill set which makes that person a suitable choice to determine the issue. In those circumstances, it is prudent to give the expert some flexibility as to the manner in which the process is to be conducted. Often the clauses will expressly provide for the expert to proceed in any manner he or she thinks fit subject to complying with certain minimum requirements and enable the expert to conduct any investigation which he or she considers necessary to make the determination, examine such documents and interview such persons as he or she may require<sup>13</sup>.

## AGREEMENT WITH EXPERT

It is not unusual to find a clause which makes the commencement of the expert determination conditional on the parties entering into an agreement with the expert. Considerable care must be taken with these clauses which can form the basis of a challenge to the expert determination process on the basis that they create an agreement to agree. An expert determination clause, like any alternate dispute resolution clause, must prescribe the conduct required of the parties for participation in the process with sufficient certainty in order to be enforceable.

If execution of a form of agreement is to be a pre-requisite to the commencement of the expert determination, then it is prudent to specify the form of agreement. Alternatively, if you do not intend to require a formal agreement then you need to make sure an expert will agree to determine the matter which, is likely to depend on whether the expert is satisfied as to his or her ability to be paid and the extent of his or her liability including the terms of the release and indemnity.

<sup>10</sup> *Triarno Pty Ltd v Triden Contractors Ltd* (1992) 10 BCL 305. The approach of Cole J was followed by Rolfe J in *Fletcher Construction Australia Ltd v MPN Group Pty Ltd* (Unreported, Supreme Court of NSW, Rolfe J, 14 July 1997) and stated that "[i]n my opinion, this decision is authority for the proposition, which I consider is correct, that in the absence of agreement as to procedures, they are to be decided by the expert" (at 23 – 24).

<sup>11</sup> *Zeke Services Pty Ltd v Traffic Technologies Ltd* [2005] 2 Qd R 563.

<sup>12</sup> *Kanivah Holdings Pty Ltd v Holdsworth Properties Pty Ltd* (2002) 11 BPR 20,201.

<sup>13</sup> See, for example, *Property Council of Australia, Project Contract PC-1* (Property Council of Australia 1998).



## THE EXPERT IS NOT AN ARBITRATOR

Where the parties wish to refer the issue to expert determination, it is common for the expert determination clause to state that the person to decide the relevant issue is an expert and not an arbitrator and that the process is that of an expert determination and not an arbitration.

The effect of the words “acting as an expert and not as an arbitrator” is to avoid the necessity for the valuer to hear evidence and the parties and to determine judicially between them. They enable the valuer to rely on his or her own investigations, skill and judgment.<sup>14</sup>

Where the parties fail to identify whether the person is to act as an arbitrator or an expert there is no presumption that the person acts in one capacity or the other. Accordingly, where a party wishes to have the benefit of an expert determination rather than an arbitration, it is prudent to include such a clause which will be regarded as significantly indicative of the intention of the parties as to the nature of the task to be undertaken, but such a clause is not conclusive of its character.<sup>15</sup>

If there is any doubt, the issue may be resolved by examining the procedure to be adopted, assuming, of course, that the clause sets out the process to be followed. If the procedure is in the nature of a judicial inquiry, then it is more likely that the clause will be held to be an agreement to arbitrate. Some indicia of such an inquiry include whether:

- the parties have the right to be heard if they so desire;
- the parties are each entitled to see and hear the evidence advanced by their respective opponents;
- the parties have the right to give evidence if they so desire; and
- each party is entitled to test by cross examination or by other appropriate means the opposing case and to answer the opposing case.

<sup>14</sup> *Legal and General Life of Australia Ltd v A Hudson Pty Ltd* (1985) 1 NSWLR 314, 336.

<sup>15</sup> *Badgin Nominees Pty Ltd v Oneida Ltd* [1998] VSC 188 (18 December 1988) [56].

## FINAL AND BINDING OR NON-BINDING

The expert determination clause can specify that the expert determination will be:

- final and binding;
- final and binding except in the case of manifest error;
- final and binding in respect of claims under a specified monetary value; or
- non-binding.

As to the meaning of “manifest error”, guidance may be obtained from the cases where leave has been sought to appeal from arbitral awards under the previous uniform legislative regime governing commercial arbitration in the States and Territories of Australia. The words “a manifest error of law on the face of the award” is a phrase which is to be read and understood as expressing the one idea. An error of law either exists or does not exist; there is no twilight zone between the two possibilities. What is required is that the existence of the error be manifest on the face of the award, including the reasons given by the arbitrator, in the sense of apparent to that understanding by the reader of the award.

The term has also been considered in other contexts concerning arbitral awards to mean “an error in the award on a mere reading of the award even without the benefit of adversarial argument”. It is suggested that the term manifest error equates to being “obviously wrong”. Taking from the United Kingdom, the concept of manifest error has been held to encompass “oversights and blunders so obvious and obviously capable of affecting the determination as to admit no difference of opinion”<sup>16</sup>

Occasionally, the expert determination clause will provide a threshold value for disputes which are subject to binding expert determinations and those which are not. Invariably, where these clauses are used, the parties attempt to impose, what they consider to be, a low value threshold value for binding expert determinations.

The threshold value is usually tied to the value of the claim itself. Other such clauses tie the threshold value to the outcome of the determination. Considerable care must be exercised when agreeing to the latter. A substantial claim could well be dismissed with the consequence of the claim being finally determined.

Some expert determination clauses are expressed to be non-binding, but nevertheless the parties are required to participate in that process prior to a further dispute resolution process taking place such as litigation or arbitration. Alternatively, the clause will state that the determination is final and binding unless one of the parties gives a notice of appeal within a stipulated timeframe of the determination being made.

The reason for making an expert determination non-binding may be to give the parties a guide as to how the dispute might be decided if it was pursued through a binding process with a view to assisting the parties resolve the issue by agreement. The disadvantage of a non-binding determination is that it might embolden the successful party into what might ultimately turn out to be a false sense of security because an expert determination will not ordinarily apply the same degree of rigour as an arbitrator or a judge would be expected to apply and may, ultimately, be held to have been wrongly decided.

## DETERMINATION OF THE EXPERT

There is no necessity to require reasons and if reasons are not required, an expert can fulfil his or her obligation simply by answering the question. If, however, it is accepted that the users of commercial contracts are likely to want to be satisfied that the determination is supported by reasoning that is sufficiently adequate to be understood by company management, it is likely that reasons will be required to be provided by the expert. Inevitably, those reasons will be scrutinised by the unsuccessful party to determine if a basis exists to challenge the determination.

The meaning of “sufficient reasons” obliges the expert to disclose what he or she did, only to the extent necessary to enable the parties, to see whether the expert has complied with the requirements of the clause by having regard to the matters to which he or she was obliged to have regard, and by disregarding the matters which he or she was obliged to disregard.



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<sup>16</sup> *Veba Oil Supply & Trading GmbH v Petrotrade Inc* [2002] BLR 54, 61.



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