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Précis Paper

Challenging Expert Determinations

Barrister Benjamin Whitten and Director of Forensic Services Paul Vincent discuss issues in challenging expert determinations and examine the successful challenge in *Middlemount South Pty Ltd v Anglo American Metallurgical Coal Assets Pty Ltd & Anor* [2020] QCA 132 (16 June 2020), a case which involved them both.

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Discussion Includes

Part 1

- Interest of case
- Points to note
- General issues of expert determination
- Principles of challenging expert determinations
- Expert or arbitrator?
- Manifest error
- Facts of the case

Part 2

- Principles of expensing and capitalising
- Rail and port accruals
- The true-up
- Take aways

Précis Paper

Challenging Expert Determinations

In this edition of BenchTV, Benjamin Whitten (Barrister) and Paul Vincent (Director of Forensic Services) examine the issues in challenging an expert determination in *Middlemount South Pty Ltd v Anglo American Metallurgical Coal Assets Pty Ltd & Anor* [2020] QCA 132 (16 June 2020).

Part 1

Interest of case

1. This is an interesting decision because it deals largely with how one might go about having an expert determination reviewed, not just on the basis of manifest error but on the basis that the expert failed to do what they were engaged to do. That was the main point of attack in the case.
2. It is also interesting in a factual sense because although there are a lot of accounting details involved in it, it is a very real proposition that when one business is sold to another entity there has to be a final accounting at the end of the day, and this case deals with how that final accounting was undertaken in accordance with the terms of the sale and purchase agreement (SPA).
3. There was a lot of evidence as to whether the undertaking by the expert in the case, an accountant from a reputable firm, was in compliance with the terms of the SPA regime that set out how to go about completing these accounts, and examination of technical accounting terms.

Points to note

4. Look at the expert determination clause in the contract of sale to determine precisely what it means and precisely what the expert has to do. Then you have to look at what the terms of engagement are going to be for that expert because the terms of engagement can enlarge what the contract allows the expert to do. And can confine it as well.
5. Those two pieces of contract are particularly important. Then you have to analyse what the expert has undertaken and whether it complies with the terms of the contract or has acted outside of the considerations the contract provides for.

General issues of expert determination

6. There are grounds on which lawyers will challenge an expert determination. In a lot of construction and large commercial cases there are Scott v Avery clauses and expert determination clauses where the parties have decided that for certain matters they should

go off to expert determination to be resolved. That saves a lot of time and litigation. Similarly to arbitration, it is private. But it is usually final and binding, subject to manifest error.

7. It is important to define what the disputes are.

Principles of challenging expert determinations

8. This examines the principles both at first instance, *Middlemount South Pty Ltd v Anglo American Metallurgical Coal Assets Pty Ltd & Anor* [2019] QSC 211, and at appeal.
9. The first thing to do when challenging an expert determination is to see whether the expert has carried out the task contractually required.
10. In *Australian Vintage Limited v Belvino Investments No 2 Pty Ltd* [2015] NSWCA 275 Chief Justice Bathurst said: "if the expert had 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".
11. In the UK case of *Jones v Sherwood Computer Services plc* [1992] 1 WLR 227 Lord Justice Dillon said:

> *"On principle, the first step must be to see what the parties have agreed to remit to the expert, this being, as Lord Denning MR said in* Campbell v Edwards*, a matter of contract. The next step must be to see what the nature of the mistake was, if there is evidence to show that. If the mistake made was that the expert departed from his instructions in a material respect… either party would be able to say that the certificate was not binding because the expert had not done what he was appointed to do."*

12. In another UK case*, Veba Oil Supply & Trading GmbH v Petrotrade Inc* [2002] 1 All ER 703, the Court of Appeal considered how the court should approach the question of whether departure from instructions was material: "Once a material departure from instructions is established, the court is not concerned with its effect on the result".
13. The position is accurately stated in *Shell UK Ltd v Enterprise Oil plc* [1999] 2 All ER (Comm) 87 where Justice Lloyd held that:

> *"The determination in those circumstances is simply not binding on the parties given the material departure vitiates the determination whether or not it affects the result. It could hardly be the effect on the result which determines the materiality of the departure in the first place. Rather I would hold any departure to be material unless it can truly be characterised as trivial or de minimis in the sense of it being obvious that it could make no possible difference to either party*."

14. In a similar vein, Justice Nettle in *AGL Victoria Pty Ltd v SPI Networks (Gas) Pty Ltd & VENCorp* [2006] VSCA 173 said it all depends upon whether or not the task that the expert has undertaken conforms with the instructions in a material way.

Expert or arbitrator?

15. Another manner of challenging an expert is where the expert acts as an arbitrator and not as an expert. There is a distinction between an expert and an arbitrator. Generally, an arbitrator calls for and receives submissions and evidence, and makes a determination on the balance of considerations based on these whereas an expert just has material before it, and decides the matter based upon that material.
16. The House of Lords set out non-exhaustive indicia of arbitration in *Arenson v Casson Beckman Rutley & Co* [1977] AC 405:

> "(a) there is a dispute or a difference between the parties which has been formulated in some way or another;
>
> (b) the dispute or difference has been remitted by the parties to the person to resolve in such a manner that he is called on to exercise a judicial function;
>
> (c) where appropriate, the parties must have been provided with an opportunity to present evidence and/or submissions in support of their respective claims in the dispute; and
>
> (d) the parties have agreed to accept his decision."

Manifest error

17. It is fairly non-contentious that manifest error is an error on the face of determination. There has been jurisprudence which talks about whether apparent error is something that has to be on the face or in the context of the determination.
18. The NSW Supreme Court decision of *TX Australia Pty Limited v Broadcast Australia Pty Limited* [2012] NSWSC 4 (16 January 2012) held that the "determination would not be binding on the parties in the case of manifest error, negligence, fraud, or error of law". Justice Brereton considered:

> *"In this context, a 'manifest error' is an error presented upon the face of the Expert's determination and accompanying reasons, and does not distinguish between 'facile errors' and 'those of complexity', nor between obvious errors and less obvious errors, nor between errors of law and errors of fact … The key requirement is that the error be apparent on the face of the determination and reasons."*

19. In *Glenvill Projects Pty Ltd v North North Melbourne Pty Ltd* [2013] VSC 717, Justice Vickery found there was no manifest error in the accepted sense of any error being apparent on the face of the determination.
20. The High Court in *Westport Insurance Corporation v Gordian Runoff Limited* [2011] HCA 37 in the course of considering the limited circumstances in which judicial review of arbitral awards may be permitted, said of the phrase a "manifest error of law on the face of the award", in paragraph (b)(i) of s 38(5) of the *Commercial Arbitration Act 1984* (NSW): "Paragraph (b)(i) of s 38(5) may be awkwardly expressed, but the words 'a manifest error of

law on the face of the award' comprise 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. But what is required here is that the existence of 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."

21. The cases show that it is important that the error be apparent on the face of the award of the reasons and it does not really matter whether it is a complex or facile error.

Facts of the case

22. *Middlemount South Pty Ltd v Anglo American Metallurgical Coal Assets Pty Ltd & Anor* [2020] QCA 132 was a case about the sale of a coal mine.
23. Anglo American Metallurgical Coal Assets Pty Ltd (Anglo) directly and indirectly held about a 70 per cent share of the control of the Foxleigh Coal Mine in Queensland and wanted to sell that share.
24. In 2015, it took steps to find a buyer. It set up a data room for potential buyers and had them sign a confidentiality agreement so they could look at information in the data room and satisfy themselves what they were buying was worth the price.
25. Ultimately, Middlemount South Pty Ltd (Middlemount), a company interested in buying Foxleigh, entered into a share purchase agreement (SPA) with Anglo. Underpinning the agreement was that the purchaser needed to be assured there was not going to be any change to the business from the time of signing the contract to the time of completion. In order to do that, a clause was inserted which obliged Anglo to carry on the business pending completion "in the ordinary course and substantially consistent with past practice", cl 5.1 of the SPA.
26. That was an overarching requirement for all of the steps to be undertaken in the agreement.
27. The agreement was signed in April 2016 and completed in August 2016.
28. Under the agreement, an initial purchase price had to be paid before completion, and then the initial purchase price was adjusted by the completion accounts.
29. The main issue in the case was calculation of the completion accounts after completion. The parties could not agree upon it and sent it off for expert determination.
30. The purchase price was broken into two parts: (i) the initial purchase price and (ii) adjustment to the initial purchase price by a mechanism involving what is called the final completion amount.
31. The final completion amount was determined in accordance with rules in the agreement set out in Clause 8 and Schedule 11. The rules allowed for the parties to agree on the completion amount, and if they did not agree, then to appoint an independent expert.
32. Clause 8 sets out how the completion accounts were to be prepared. Clause 8.2 said the completion accounts were mandatory and must be prepared and the final completion amount must be calculated in accordance with the completion account principles set out

in Schedule 11, and in accordance with Schedule 12, which was an example of the accounting items that were usually used in completion accounts. Schedule 11 became the focus.

33. Clause 8.5 said effectively what had to happen was that the purchaser, within 40 days of completion, had to provide Anglo with their completion accounts based upon the information that they extracted from the data room and the accounts that they knew had existed up to that point in time. If Anglo disagreed, they would provide a dispute notice setting out details of each matter in dispute and reasons why they were disputed. Then, if Middlemount did not agree with that, they would set out a response. Then they would try to agree, and if they could not agree, they would be able to send it off to an independent accountant, who is the expert in this particular matter.
34. Clause 8.5(h) sets out:

> *"The Independent Accountant must act as an expert and not as an arbitrator and its written determination will be final and binding on the parties in the absence of manifest error, and the Completion Accounts or the Final Completion Amount (as applicable) will be deemed to be amended accordingly and will be taken to comprise the final Completion Accounts and the Final Completion Amount and will be final and binding on the parties."*

35. There's a carve out for manifest error. There's no carve out for failing to do the task that the expert was engaged about but that's a principle of law that comes into play so doesn't need to be in that particular clause.
36. After completion on 29 August 2016, Middlemount provided Anglo with completion accounts on 31 October 2016. That said, as far as Middlemount was concerned, they would pay an extra $3.4 million. Anglo disputed that in a notice of dispute on 30 January 2017, and Middlemount provided its response on 23 February 2017.
37. The combination of that dispute notice and the response meant that there were ultimately two main issues. First, the treatment in those completion accounts of the loader maintenance accruals. Second, the treatment of the rail and port costs accruals.
38. Schedule 11 was a cascading set of rules, a hierarchy of precedence of what one needed to use in order to prepare the accounts.
39. Clause 1.1 of sch 11 to the Agreement states: "The completion accounts must be prepared in accordance with, in order of precedence:
    (a) The format prescribed in Schedule 12C (with a worked example of Schedule 12C based on the trial balance set out at Schedule 12B);
    (b) Where an item is not covered by the accounting principles, policies and procedures referred to in clause (a), the specific principles, policies and procedures set out in Part 1.2 of this Schedule 11.
    (c) Where an item is not covered by the accounting principles, policies and procedures referred to in clause (a) or (b), in a manner consistent with the principles, policies and procedures used to prepare the trial balance.

(d) Where an item is not covered by the accounting principles, policies and procedures referred to in clause (a), (b) or (c), in a manner consistent with the principles, policies and procedures used to prepare the Accounts; and

(e) Where an item is not covered by the accounting principles, policies and procedures referred to in clause (a), (b), (c) or (d), in accordance with the Accounting Standards."

40. Middlemount's case was argued on the basis that one had to look at the trial balance and, if that item had been used in the trial balance, one had to use that item in the same way as it had been used previously, provided one can establish that it was used in accordance with the policy, or a procedure or a principle.
41. The independent accountant made the determination that there was a further $8.2 million to be paid in the completion amount. Middlemount decided to dispute. As such, the challenge to the expert determination hinged on around $3.5 million worth of value, being (i) the treatment of the loader maintenance spare parts and (ii) the treatment of the rail and port costs accruals.
42. Insofar as the loader maintenance spare parts were concerned, Anglo purchased a bunch of loader spare parts in December 2015, that is, around the time it was marketing the coal mine. When it did so, it expensed those parts on its accounts, and it did that each month up until July 2016.
43. Then in August, the month of completion, Anglo changed it to a capital expense. Middlemount disputed that Anglo was permitted to change that treatment.

Video part 2 starts here

Part 2

Principles of expensing and capitalising

44. The agreement was entered into in April 2016 based on a set of financial statements that were in the data room. They effectively showed the balance sheet of the business.
45. As the transaction was not completed until a few months later, the business continued on. The purchaser was entitled to assume that the business continued as usual, in the way in which the business was conducted prior to April 2016. If there was any difference, then the balance sheet in April 2016 and the balance sheet at completion would be compared and the purchase price would be adjusted.
46. With regard to the loader spare parts, the purchase of spare parts was immediately expensed and went to the profit and loss account. As such, the balance sheet did not show any spare parts. What Anglo did at the date of completion was put the spare parts as an asset in the balance sheet. It hence increased the value of the equity in the business and pushed up the adjusted price.
47. The decision was based on the 2015 Special Purpose Annual Report (the 2015 Report) which included a policy that stated that if an item is not used within 45 days, it has to be capitalised.

48. What Anglo did at the date of completion was inconsistent with their normal practice in producing their trial balance each month.
49. The argument was that treating the spare parts as assets at completion was inconsistent with the way the vendor was keeping its records and an "unexpected" adjustment from the point of view of Middlemount, the purchaser.
50. On the flip side, Anglo said it was not incorrect on their part because what they were doing was fixing an error they made in accounting. They did not recognise the error until completion. Applying it as a capital item was consistent with the policy they had in the 2015 Report.
51. The difficulty was that the expert found that the loader maintenance spare parts had in fact been applied as expense items in the accounts. He felt he was entitled to accept that the error had been made, and the proper application of accounting principles, the policy and the 2015 Report was to apply it as a capital item. He accepted that the treatment of that item as capital was correct.
52. He went further, saying that having regard to the physical condition and location, the control of the spare parts was transferred to the purchaser, the spare parts satisfied the definition of an "asset" under accounting standards, these assets were under the control of the purchaser from the date of completion, the vendor did not account for the assets on a timely basis and the purchaser could benefit from these assets into the future. That went beyond his obligations as an investigating accountant.
53. In his letter of engagement, the independent accountant said he considered not only the SPA terms and the dispute in response, but also common industry practice in relation to relevant accounting practices and who benefitted or incurred a loss based on the supporting evidence provided. That was beyond the remit that had been provided to him.
54. Nevertheless, when the determination was handed down, Middlemount had by that time launched a large case against Anglo on other matters, and this expert determination was part of it. As such, Anglo applied to set it out and have a separate hearing. The Court agreed.
55. In the separate determination, insofar as the loader maintenance spare parts were concerned, Justice Jackson agreed with the independent accountant. He said the treatment of the spare parts item regularly as an expense could arguably be a "procedure" in the principles, policies and procedures of Schedule 11, but that was not an absolute proposition.
56. If it were an absolute proposition that it had been used as a procedure beforehand, Anglo couldn't correct an error in the accounts. And it didn't take into account variations in how an item might have been treated over time. The Judge held the consistent use by Anglo expensing these items over months might have been a procedure but that did not matter as an absolute proposition because of those two reasons. That entitled the independent accountant to then look at the accounts.
57. A Goods Holding policy in the 2015 Report said if an item was held for longer than a certain period, it gets capitalised. Justice Jackson said Anglo were allowed to make that change to

correct the error and that correction would then bring it into consistency with the accounts set out in 2015.

58. Middlemount appealed that part of the decision, and the Court of Appeal agreed with Middlemount that the primary judge had erred in doing so. The Court of Appeal focused on the word "used" in cl 1.1(c) of Schedule 11:

> *"Where an item is not covered by the accounting principles, policies and procedures referred to in clause (a) or (b), in a 'manner consistent with the principles, policies and procedures used to prepare the trial balance'."*

59. The critical word was "used". Middlemount argued the expert had to focus on what had been used. Was there a procedure that had been used in the trial balances? If there was, then there was no warrant to go any further down the cascading order of precedence and to use the accounts. The expert in this case had in fact determined that by expensing these items, that was a procedure that had been used by Anglo.
60. On this particular issue, the Court of Appeal said the question for the primary judge was whether the independent accountant had failed to perform the task they had contracted to perform, which was to determine whether the completion accounts had been prepared in accordance with the terms of the agreement and relevantly in the order of the precedence set out in Schedule 11.
61. The Court of Appeal said the intent of the underlying obligation set out in cl 5.1 obliged Anglo to carry on the business pending completion "in the ordinary course and substantially consistent with past practice".
62. The Court of Appeal held the primary judge had erred in failing to address the finding of the independent accountant that the procedure used for the spare parts was to expense them over many months. That part of the appeal was upheld.
63. The majority of the Court also held that there was a difficulty in applying the Goods Holding policy and the 2015 Report because there was no finding by the independent accountant that they had been used in the trial balances in the months leading up to August 2016.
64. Therefore, the Court held that the independent accountant strayed from the task he was contracted to perform by diverting his attention from what was done to what should have been done. It was the terms of the agreement by the use of the word "used" which ensured that the independent accountant had to direct the focus of his attention to what had been done rather than what should have been done.

<u>Rail and port accruals</u>

65. This involved take or pay contracts and true-up accounting.
66. Two parties doing business together enter into a contract. There is some expectation, over a period of 12 months, that the purchasing party will acquire a certain amount of services from the provider, and the provider will be able to provide them. There is some risk in that the purchaser will commit to buy a certain amount of items and the vendor will ensure this

is covered. Because of this agreement the vendor strikes a good deal. However, if the purchaser purchases less, he is still obliged to pay a price for the goods he intended to buy – hence take or pay.

67. At the end of the year you would generally make the take or pay adjustment.

The true-up

68. The true-up is saying, at what point of time do we look at it and say, this is what we contracted, this is what actually happened, this is what we've accrued, let's align the whole lot so we make the accounts accurate and reflect in the financial statement what's happened at a particular date.
69. In this case, the true-up was done at completion, so the liabilities were backed out and the net assets increased to the extent the liabilities were backed out. It was the timing of the true-up that caused the dispute.
70. Middlemount had argued in the expert determination that there was one occasion in November 2015 when Anglo had done a true-up of the 2015 accounts and that was consistent with doing it close to the end of the financial year.
71. In accordance with cl 1.1(d) of Schedule 11, Middlemount said Anglo ought to have done the same thing in 2016, that is, do the true-up close to the end of the calendar year, their financial year, instead of doing it in August. By doing it in August, they changed the rules, effectively creating a much greater liability for Middlemount in the process.
72. The independent accountant agreed with Anglo that there was no policy to do it at the end of the financial year. There was in fact one policy which was the recognition of the existing obligations policy as set out in 2015 Report which was consistent with the way that Anglo did the true-up in August 2016.
73. Anglo knew by August 2016 how much the annual accounts were and it was right for them to then actually account for them. The supplier had a June to July financial year whereas Anglo had a January to December financial year. So Anglo held that they knew what the supplier was going to charge them for the June to July financial year but they did not know what the supplier was going to charge them from August to December. Hence, they did the true-up.
74. It gets back to the issue of what is the normal procedure in doing the true-up and whether they ought to have done it at the date of completion or waited till the accounts were finalised in December. These are interesting accounting arguments and sometimes they get challenged.
75. Insofar as the legal principles are concerned, Middlemount was trying toen force the order of precedence of the regime as set out in cl 1.1 of Schedule 11 by trying to establish that there was in fact a procedure that had been used for the preparation of each monthly trial balance, which was to have the accruals held over for month to month up to the end of the financial year. Justice Jackson ultimately decided he did not have to deal with that

particular issue because it was a matter for the experts to determine precisely whether the policy that Anglo had applied was correct. The Court's determination of that was completely irrelevant. The Court was not convinced that the evidence of the one incident was sufficient to constitute a procedure which the independent accountant could rely on, and by relying on it, he committed a manifest error.

76. Insofar as the loader maintenance was concerned, Middlemount succeeded on that part of the appeal.
77. Insofar as the rail and port costs were concerned, Middlemount failed on that part of the appeal, on the basis that there was no proven policy, principle or procedure for the trial balance and the Court did not accept that the one true-up that occurred in November could consist of a procedure per se.

Take aways

78. The take away from a lawyer's perspective is when one is dealing with a SPA for any business, one has to properly identify with detailed precision, what is going to be used to formulate the calculation of completion accounts. invariably in big business there's going to be a gap between signing the agreement and completion. And ordinarily, there is going to be a scheme or mechanism in which the completion accounts are going to be prepared to enable the parties to get to a true accounting position at completion. That, in this case, was informed and coloured by the clause that said there was not to be any change in the business practices. That was the way the Court of Appeal looked at how this case, as an overarching theme, should have been determined.
79. It's also very useful to test those clauses in those sale purchase agreements to determine the completion accounts and run them by accountants who regularly deal with that, so that from a legal perspective you get the words right, but also from an accounting perspective you get the procedures right. That's a key take away.
80. There needed to be in this case a definition of what trial balance meant, what 'used' meant, what constituted a procedure, and what the accounts were could have been fleshed out more. In the terms of engagement of the expert carefully define what the terms of the dispute are. And deal with the issue of severance.

BIOGRAPHY

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Having practised both as a solicitor and as a barrister Mr Whitten has gained considerable practical experience in representing companies, business and individuals in mediations and in interlocutory, trial and appeal hearings in all levels of State and Federal courts. He is a Fellow of the Commercial Law Association of Australia, the Australian Restructuring and Insolvency Turnaround Association, the Australian Insurance Law Association, the Society of Construction Law of Australia, the Building Dispute Practitioners Society, and an interstate member of the Melbourne Technology Engineering and Construction Chambers.

Paul Vincent

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Mr Vincent's expertise is in commercial litigation disputes, financial crime, professional negligence and family law matters. He is also an active member of Chartered Accountant Australia & New Zealand (CAANZ) and was National Chairman (2000 – 2005) and Queensland Chairman (1999 – 2005) of the CAANZ's Forensic Accounting Special Interest Group (FASIG).

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Middlemount South Pty Ltd v Anglo American Metallurgical Coal Assets Pty Ltd & Anor [2020] QCA 132

Benchmark Link

https://benchmarkinc.com.au/benchmark/composite/benchmark_24-06-2020_insurance_banking_construction_government.pdf

Judgment Link

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Legislation

Commercial Arbitration Act 1984 (NSW)