VICTORIA

WHEN ARE FINAL & BINDING GAS DETERMINATIONS OPEN TO REVIEW? *

AGL Victoria Pty Ltd v SPI Networks (Gas) Pty Ltd & VENCorp [2006] VSCA 173

Contract – Expert determination – Mistake – Gas distribution tariff agreement – Unaccounted for gas reconciliation amount – Whether determination reviewable for mistake of fact.

Introduction

The Court of Appeal of the Supreme Court of Victoria recently delivered its decision in *AGL Victoria Pty Ltd v SPI Networks (Gas) Pty Ltd & VENCorp*[1]. The Court allowed the appeal of AGL from an earlier decision of Justice Byrne at first instance[2] and made declarations requiring VENCorp to re-calculate its determinations of Reconciliation Amounts for unaccounted for gas (UAFG) for the 1999 and 2000 years despite the fact that the contract between the parties provided those determinations were to be final and binding.

The Court of Appeal decision may, if followed, have implications for drafting agreements between parties who wish to ensure the effectiveness of contractual provisions relating to determinations or valuations by independent third parties which are intended to be final and binding.

Background

SPI Networks is the owner of a pipeline network which carries natural gas from the high pressure transmission system to customers who are domestic and commercial users of gas. SPI Networks is one of the three licensed gas distributors in Victoria. AGL is a retailer of gas which, amongst other retailers, sells gas to domestic and commercial gas users which is transported by SPI Networks as distributor.

The contractual relationship between SPI Networks and AGL is contained in a Distribution Tariff Agreement (DTA) entered into in 1998 between Westar Pty Ltd (as SPI Networks was then known) and Ikon Energy Pty Ltd (as AGL was then known). Clause 8.4(a) of the DTA provided for a Reconciliation Amount for UAFG to be calculated by VENCorp under Schedule 8 of the System Connection Deed. Clause 8.5(b) of the DTA provided:

> The calculation by VENCorp of the Reconciliation Amount shall be final and binding on Distributor [SPI Networks] and Shipper [AGL].

SPI Networks and VENCorp were parties to a System Connection Deed which provided in Schedule 8 for the calculation by VENCorp of UAFG Reconciliation Amounts.

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1 [2006] VSCA 173.

2 *AGL Victoria Pty Ltd v TXU Networks (Gas) Pty Ltd & Anor* [2004] VSC 225.

It is accepted that there will always be some leakage of gas from any distribution system. The UAFG Reconciliation Amount determination was designed to measure the extent to which gas was lost from the system to an extent either greater than or less than certain benchmarks.

The formula under which VENCorp was to determine the UAFG Reconciliation Amounts was defined as (X+Y) x (B-A). Each of these integers was defined in the relevant agreements. In particular integer A was defined as being equal to D-(E/1-G) where:

> D = the quantity of Gas withdrawn from the Transmission System by [SPI Networks] for [AGL] … at the Connection Points for the previous calendar year.

In 2000 and 2001 VENCorp issued statements setting out its determinations of the UAFG Reconciliation Amounts for the 1999 and 2000 years. These statements provided for payments from AGL to SPI Networks totaling approximately $6.2 million.

In May 2002 VENCorp discovered that gas had been flowing through an unmetered connection between the gas transmission system and SPI Network's distribution system. VENCorp concluded this connection had been unmetered since at least March 1999. The consequence of this was that a significant quantity of gas had flowed into SPI Network's distribution system during the 1999 and 200 years which had previously been unmeasured.

VENCorp calculated that if this estimated quantity of gas had been factored into its 1999 and 2000 UAFG Reconciliation Amounts, payments of approximately $4.5 million would have been payable by SPI Networks to AGL.

In substance, the unmetered gas flow had the effect that the calculation by VENCorp of Factor D was incorrect because the figures used by VENCorp in reaching its determinations for the 1999 and 2000 was later shown to have been dependant on metering data for gas injections which was incorrect.

In the period following the discovery of the unmetered gas flow, VENCorp, as it was required to do, calculated a re-settlement of the gas market under clause 3.6.19(b) of the Market System & Operation Rules (MSO Rules). These rules regulate the market for the purchase and sale of gas and require, in the case of any discovery of metering error, that VENCorp recalculate market settlements. The DTA in contrast did not require the re-calculation of the UAFG calculations and VENCorp declined to do so. SPI Networks declined to agree to the requests by AGL to permit VENCorp to recalculate the UAFG Reconciliation Amounts on the basis it regarded the original determinations by VENCorp to be final and binding.

AGL commenced proceedings in the Supreme Court of Victoria seeking declarations that in calculating the 1999 and 2000 Reconciliation Amounts, VENCorp had not complied with its contractual obligations and sought orders requiring the determinations to be re-calculated.

The Decision of Justice Byrne

At first instance, Byrne J rejected AGL claims that the determinations by VENCorp could be reviewed. AGL's claim was dismissed.

In reaching this conclusion, Byrne J considered a number of decisions concerning the circumstances in which a Court may intervene to review and overturn expert valuations and determinations. The leading decision considered was that of the New South Wales Court of Appeal in *Legal & General Life of Aust Ltd v A Hudson Pty Ltd*[3] and in particular the reasoning of McHugh J who said inter alia:

> It will be difficult, and usually impossible, however, to imply a term that a valuation can be set aside on the ground of the valuer's mistake or because the valuation is unreasonable. By referring the decision to a valuer, the parties agree to accept his honest and impartial decision…. They rely on his skill and judgment and agree to be bound by his decision. While mistake or error on the part of the valuer is not by itself sufficient to in validate the decision…, nevertheless the mistake may be of a kind which shows that the valuation is not in accordance with the contract. …The question is not whether there is an error in the discretionary judgment of the valuer. It is whether the valuation complies with the terms of the contract.[4]

Byrne J also referred to *WMC Resources Ltd v Leighton Contractors Pty Ltd*[5] as authority for the proposition that a determination calling for the exercise of discretionary judgment by a valuer will not be reviewable while one involving a merely mechanical exercise may be set aside and corrected by a Court or by an arbitrator unless the contract by a final and binding clause, indicated that remedy was not available.

Byrne J referred to *Jones v Sherwood Computer Services Plc*[6] as authority in support of the principle that a valuation may not be reviewed in the case where the parties have expressed the determination to be final and binding for all purposes and where they have indicated a preference for a speedy determination without the delay and complexity of subsequent review.

Applying these principles to the facts of this case, Byrne J concluded that the task of VENCorp in determining the reconciliation amounts included the task of determining Factor D which involved the exercise of skill and judgment and which was more than a mechanical exercise. In reaching this conclusion Justice Byrne had regard to the evidence which indicated the process undertaken by VENCorp in arriving at Factor D involved the standardization, validation and conversion of raw metering data. He also concluded that the existence of the express provision that the determination was to be final and binding and the indication the parties had sought by the DTA to implement a speedy resolution mechanism of the annual reconciliation amount process did not support a conclusion the Court could review VENCorp's calculations.

Byrne J rejected AGL's submission that the provisions of the DTA should be seen as part of the matrix of facts which included an express requirement on the part of VENCorp to review market settlements under the MSO Rules. On the contrary he concluded that the DTA, in expressly providing for final and binding determinations should be contrasted with the MSO Rules and that express provision should be given effect to by the Court in not reviewing the determination.

AGL appealed to the Court of Appeal.

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3 (1985) 1 NSWLR 314

4 Ibid 335-6.

5 (1999) 20 WAR 489 at 494-9.

6 [1992] 1 WLR 277 at 285.

The Court of Appeal Decision

The Court of Appeal was comprised of Maxwell P., Nettle JA and Bongiorno AJA. The judgment of the Court in allowing the appeal was delivered by Nettle JA In overturning the decision of Byrne J, the Court of Appeal set aside VENCorp's original determinations and made declarations they be re-calculated. In reaching this conclusion, the Court characterized the task to be undertaken by VENCorp differently and applied a different emphasis to the authorities referred to.

Firstly, Nettle JA considered that the process of determining Factor D did not involve the exercise of skill and judgment in the manner found by Byrne J. He concluded that Factor D, which was defined as the volume of gas withdrawn from the transmission system was capable of objective measurement by meters installed and operated under the MSO Rules. Further Nettle JA considered that the adjustments and standardization of metering data undertaken by VENCorp should be contrasted with the ascertainment of the raw metering data. Notwithstanding that the DTA did not prescribe the manner in which VENCorp was to ascertain or determine Factor D, he concluded that the ascertainment of that raw metering data was a step in the determination of the Reconciliation Amount which was an objective discernible quantity in respect of which there was no need or room for discretion, judgment or opinion and which was therefore not beyond the scope of error based review.

Secondly, Nettle JA considered that the requirement imposed on VENCorp was that the determination it made be based on the use of *the* volume of gas withdrawn from the transmission system and not VENCorp's estimate or determination of that quantity. Accordingly, any determination based on a quantity of gas that was erroneously measured was not in accordance with the contract.

In reaching his conclusions, Nettle JA placed emphasis on a passage from *Jones v Sherwood,*[7] where Dillon LJ held that it was appropriate to first consider the nature of the task agreed to be remitted to the expert and then to consider the nature of the mistake alleged and further that:

> If the mistake made was that the expert departed from his instructions in a material respect – e.g., if he valued the wrong number of shares, or valued shares in the wrong company, … 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.[8]

Nettle JA considered that because of the mistake in the volume of gas withdrawn, VENCorp had not done what was required to be done.

Finally, Nettle JA referred to the contractual documents as commercial agreements and concluded that he did not consider that the parties as honest businessmen would have intended that a determination based on an error as to the volume of gas with consequences amounting to millions of dollars, would be final and binding as being in accordance with their agreement.

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7 [1992] 1 WLR 277.

8 Ibid, 287.

Potential Ramifications of Court of Appeal Decision

It has always been the case that determinations and valuations can be overturned in the case of fraud, collusion, dishonesty or impartiality. This was not an issue in the case discussed above and the law in that regard is unaffected.

Parties to commercial agreements often do, for reasons of expediency, speed, certainty, confidentiality or otherwise, provide in their agreements for valuation or other issues to be referred to independent third parties for determination on a final and binding basis. In so doing they take a commercial risk the determination may be in error, recognizing that the law has traditionally offered very limited grounds for review.

It is possible that the decision of the Court of Appeal will, if followed, expand the bases upon which parties to a contract dissatisfied with a decision of a valuer or expert, may seek to review and overturn a determination.

In particular, in future cases, a party dissatisfied with an expert determination may seek to persuade the Courts to analyse the methodology undertaken by the expert and, where errors of objective fact are identified as part of that process, seek to have the determination set aside.

Clearly each case will depend on the particular terms of each contract, the actual task undertaken by the expert and the nature of the alleged mistake, so each case will turn on its own facts. For that reason, if parties do wish determinations to be final and binding, and are prepared to take the commercial risk of error or mistake, then care should be taken in drafting contractual provisions to identify the extent to which review may be possible or alternatively is not permitted. Parties should not assume that the mere existence of the phrase “final and binding” will mean that determinations are so final and binding in all cases.

MINERAL RESOURCES (SUSTAINABLE DEVELOPMENT) ACT 2006 — KEY CHANGES*

Introduction

The Victorian *Mineral Resources Development Act 1990* (‘the *1990 Act’*) was amended and renamed the *Mineral Resources (Sustainable Development) Act 2006 (*‘the *2006 Act*’*)* on 31 August 2006. It was not just a name change. The 2006 Act now expressly incorporates principles of sustainability to guide the decision-making process under the Act. Further, the Act now includes detailed provisions aimed at fostering increased community engagement by mining companies. The Act also removes many of the uncertainties that have become apparent since the Act commenced operation.

The amendments to the 1990 Act were introduced partly in response to an inquiry launched by the Government in 2005 into the operation of sections 45 and 46 of the *Mineral Resources and*

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