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Superintendent's certificates involving discretion in Australia: where's Crouch?

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In our January 2013 edition, David Levin QC brought us an Insight on a case from Victoria, Australia, which shone a spotlight on experts giving evidence and various other matters.¹ That state's Court of Appeal has now affirmed that decision in *Dura (Australia) Constructions Pty Ltd v Hue Boutique Living Pty Ltd*.² This judgment suggests – controversially, and contrary to relevant English authority – that a superintendent's certificate is likely to be found to be final and binding in Australia and not be reopened by a court on the merits.

The Victorian Court of Appeal's judgment in *Dura* endorsed the decision of the Full Court of the Supreme Court of Western Australia in *WMC Resources v Leighton Contractors*

Pty,³ and rejected the English approach of the House of Lords in *Beaufort Developments (NI) Ltd v Gilbert-Ash NI Ltd*.⁴

Both *WMC* and *Dura* held that whether or

not the parties to a building contract intended a certificate by a superintendent to be final and binding might be determined by whether or not the decision of the superintendent in question involves the exercise of a discretion or merely a mechanical computation. Where a discretionary judgment is involved, therefore, the Australian courts are more likely to find the parties intended the decision to be final and binding. In turn, a court would not reopen the decision and an arbitrator may not have power to reopen it.

In the author's opinion, most certifications made by a superintendent involve discretion in the way the courts have defined it. The recent Australian decisions represent, therefore, an unfortunate approach to the construction of building contracts that is unlikely to reflect what the parties intended. Parties intending to contract on the basis that an arbitrator has power to reopen and replace any decision a superintendent makes with his or her own should include express terms to that effect.

The effect of superintendents' certificates

Role of the contract

Building contracts typically provide for a person or organisation to perform the role of superintendent, engineer or architect in administering the contract (for consistency, the term 'superintendent' is used in this article to describe the role of issuing certificates as required by the contract). Typically, the superintendent is engaged by the principal under a contract separate to the building contract or the role is performed by the principal itself.

The authority of the superintendent under the building contract to issue certificates, and the effect of a valid certificate, is entirely defined by the terms of the building contract. Thus, the recent cases do no more than indicate a judicial approach to interpreting the terms of contracts that will, of course, depend in every case on the construction of the specific contract.

The effect of a certificate issued by a superintendent has been the subject of considerable judicial focus and case law. Some of the case law, particularly in Australia, has focused on whether a principal is bound by a certificate in a summary judgment

application. Until statutory adjudication became prevalent in Australia, this was the major method of securing cash flow by contractors. Recently, certificates have been held not to bind adjudicators exercising their statutory functions.

Other cases have concerned whether the contract gave a final and binding effect to a certificate such that a court or an arbitrator could reopen it on the merits. Two separate concepts are involved: first, whether or not a certificate is a valid certificate under the contract; and secondly, whether or not the parties intended that that certificate would conclusively determine the rights of the parties such that a merits review either could not or would not be performed by a court or arbitrator.

For a certificate to be a valid certificate under a contract, it must comply with the terms of the contract in terms of its issue and requirements of form.⁵ It is on the question of whether or not a certificate is valid that courts have historically superimposed obligations on superintendents that were not expressed in the written terms of a contract. Such obligations include the obligation to act without fraud, independently (even when an employee of the principal), impartially, honestly and fairly.

The historical approach of courts was to accord finality to a certificate but to carefully scrutinise whether the issue of the certificate complied strictly with the contractual terms. Up until about the middle of the 20th century, courts tended to see a superintendent as performing a quasi-judicial role. As a result, judicial analysis focused on the ways a certificate might be held to be invalid rather than on its reviewability.

WMC

Modern contracts are increasingly explicit in giving an unfettered discretion to the superintendent when exercising a certification role. For example, in *WMC*, the contract gave the power to the principal, WMC, to value variations performed by Leighton 'in its sole discretion'. Ipp J (with whom Kennedy and White JJ agreed) described the contractual role of determining whether or not the schedule of rates applied to a particular variation, and how variations were to be valued as being 'essentially discretionary'.⁶

He then observed that this finding was 'critical to the resolution of this appeal'⁷

in that it led him to the conclusion that the parties had intended by their contract that the valuation of variations by WMC was to be final and binding.

In the result, the Court overturned the trial judge's view that the arbitrator could review WMC's assessment of Leighton's entitlement for variations under the arbitration clause. The logic went that, because the parties had agreed that WMC would exercise discretionary judgment in valuing variations, the parties had agreed that the certificate issued would be final and binding and could not be reopened on the merits.

The arbitration clause itself in WMC could be considered to give a wide power of review to the arbitrator, as the parties had agreed the arbitrator would decide disputes 'in respect of any aspect of this Agreement or its performance or non performance'. However, the Court held that the clause did not give power to the arbitrator to reopen WMC's own certificate, given in its discretion and in its own favour.

Ipp J held the fact that the discretionary assessment had been performed by one of the parties to the agreement and not by a third party was not relevant.⁸

Criticisms

The logic in the judgment has been criticised,⁹ in the author's opinion, rightly so. Two issues seem to the author to arise.

First, the contractual basis of payment (or anything else that is certified) and the contractual process by which the entitlement or thing is assessed are different. The common lack of precision in building contracts as to how the entitlement to payment is to be calculated, for example, often relies on what appears to be a discretion in the superintendent. Nevertheless, absent failure of the contract for uncertainty, it is for the court to construe the intention of the parties as to the basis of payment. In the absence of an express term to the contrary, it would seem to the author that a reasonable construction of a contract that gives a discretion to the superintendent without more precision is that the parties intended that the contractor would be paid a fair or reasonable amount.¹⁰

Put another way, in the author's view, an agreement that gives a superintendent a discretionary power to value is unlikely to reflect an agreement between the parties

that valuation need not be reasonable. There is no reason why a discretionary assessment by a superintendent cannot be corrected to be an assessment that reflected the intention of the parties; that is, correcting a discretionary assessment that is unreasonable or wrong for some other reason.

However, in WMC, and the cases that have followed it, the judicial attention has not been on how the parties intended the thing certified to be assessed. Rather, the logic is that, because the parties have conferred a discretion to decide the thing, that is the entire contractual basis on which the thing itself is to be assessed. Thus, there is nothing to review by either a court or an arbitrator.

The second and related problem with the logic in WMC, in the author's opinion, is that the parties' agreement to give the superintendent power to make a discretionary assessment of a thing to be certified does not carry with it the implication that the parties intended that certificate to be final and binding. Agreeing that a decision maker has discretion does not entail agreeing the decision made has finality; they are logically two different attributes of the decision.

Crouch and its demise

The difference between the validity of a certificate and its effect was brought to the fore in the case of *Northern Regional Health Authority v Derek Crouch Construction Co Limited*.¹¹ In this case, the English Court of Appeal found that a broad arbitration power in the contract conferred a special power on the arbitrator to open up and review the thing certified that was not exercisable by a court. In other words, the certificate was final and binding on the court, but not final and binding on the arbitrator. Dunn LJ said that '[w]here parties have agreed on machinery of that kind for the resolution of disputes, it is not for the court to intervene and replace its own process for the contractual machinery agreed by the parties.'¹²

While *Crouch* was followed in some Australian cases,¹³ it was distinguished in others. It was somewhat challenging conceptually to see parties as intending to oust the jurisdiction of the courts but to permit an arbitrator to review the thing which was certified.

The House of Lords in *Beaufort Developments* overruled *Crouch*, holding that certificates were not final and binding

unless there were clear terms in the contract to that effect.¹⁴ It was considered that, at least in England, the position expressed in the earlier *Gilbert-Ash*¹⁵ case that the parties did not intend for superintendent's certificates to be final and binding unless they clearly expressed an agreement to this in their contracts was restored.

Divergent views in Australia and England

In *WMC* and *Dura*, however, the Australian courts have taken a different view. Both cases have held that no express words to the effect that a superintendent's certificate is final and binding are necessary for a valid certificate to be held to be final and binding. Further, in *WMC*, it was held the effect of the certificate was not only final and binding on the court, but also on the arbitrator. In *Dura*, the Court endorsed that view, albeit obiter. Whilst in *Crouch* the arbitration clause led the Court to see the jurisdiction of the court as limited, in *WMC* the superintendent's discretion in certifying led the Court to state that neither the court nor the arbitrator could review the thing certified.

Dura v Hue

In *Dura*, the principal had engaged the builder to perform building works, disputes had arisen and the principal had exercised its contractual right to take all remaining work out of the hands of the builder and have another complete the project. As is common in building contracts, at the completion of the project, the superintendent was charged with working out the financial entitlement of the principal. The terms of the contract required the superintendent to 'ascertain the cost incurred by the Principal in completing the work and... issue a certificate... certifying... the amount due from the builder.

As was discussed in David Levin's article, referred to above, the trial judge, Dixon J, addressed the question of whether or not the superintendent's certificate was final and binding under the terms of the contract¹⁶ by reference to *WMC* and the cases that have followed it. Dixon J observed:¹⁷

'The leading decision is [*WMC*]... This decision has been considered in, and supported by, more recent cases such as *AGL Victoria Pty Ltd v TXU Networks (Gas) Pty Ltd*¹⁸ and *Yarraman Pine Pty Ltd v Forestry Plantations Queensland*.¹⁹ [*WMC*] concerned

a mining contract at an open-pit nickel mine at Mt Keith in Western Australia and valuations made by WMC of work executed by Leighton Contractors that constituted variations under the contract between them. By the terms of that contract, WMC had the power to value those variations "in its sole discretion". The court was asked to determine whether that power should be interpreted as giving WMC an express right to make a final and binding determination such that an arbitrator had no power to substitute his own valuation for the valuation of WMC.'

After then considering the specific clause before him under which the superintendent was to determine the entitlement of the principal, Dixon J held:²⁰

'I am satisfied that the resultant certificate, involving discretionary judgment by the superintendent who, adopting [a quantity surveyor's] work, ascertained the costs as required by cl 44.6, followed the process contemplated by the contract and that process is not open to review for error. It is final and binding.'

On appeal, the Victorian Court of Appeal analysed a challenge that was made to the validity of the certificate on the ground that the contract required the superintendent to ascertain the financial position. The submission was that because the superintendent had relied on the work of others, this contract requirement was not met.

The Court dismissed this challenge. Similarly, it dismissed the somewhat Delphic challenge that the word 'ascertain' allowed no room for judgement and, as the superintendent had estimated the entitlement, the certificate did not comply with the contract. Thus, the certificate was upheld as valid.

However, of greater interest is how the Court then dealt with the question of whether the valid certificate was intended to be final and binding. Maxwell P, who wrote the leading judgment, held, by reference to the *AGL* case:²¹

'The question, first and last, is one of contract. What did the parties bargain for? If the determination does not satisfy the terms of the contract, then it is of no effect and, at the option of the parties, must be done again. If, on the other hand, the determination complies with the contract, the parties are bound by it.'

Somewhat strikingly, the possibility that the certificate was valid but by the contract was

not intended to oust the jurisdiction of the court to assess the thing certified for itself is not referred to in this passage. Indeed, some authors suggest that only a correct certificate is a valid certificate.²² However, the learned President did consider the effect of the valid certificate as a separate issue and strongly endorsed the approach taken in *WMC* and the cases that have followed it of focussing on the discretionary nature of the assessment to hold the intention of the parties reflected in the contract was that the certificate would be final and binding.

Maxwell P noted that '[t]he most comprehensive analysis of the applicable principles is to be found in [*WMC*]',²³ and set out those principles as enunciated by Ipp J:²⁴

1. By the contract, the parties agree to be bound by a determination made in accordance with the terms of the contract. If the valuation complies, the parties are bound.
2. A court (or an arbitrator) will not set aside a determination merely on the ground that it is incorrect or that it reveals errors. The determination will only be interfered with if it is not made in terms of the contract.
3. There will ordinarily be implied terms of the contract that the process of making the determination will be conducted honestly, bona fide and reasonably.
4. Given that the parties have bound themselves to accept a determination which complies with the contract, a statement in the contract that the

determination is "final and binding" adds little.

5. No different approach is required where, in accordance with the contract, the determination is made by one of the parties to the contract or its representative.'
- Maxwell P went on to note that the 'Full Court also elucidated the distinction between a determination which involves a "mechanical" computation and one which requires the exercise of "discretionary" judgment. The former is characterised by the application of "detailed fixed and objective criteria as to how the value of amounts to be certified... is to be determined".'²⁵

Comment

Two propositions in the list set out above are exceptional. First, beyond even the position expressed in *Crouch*, the appellate courts of both Western Australia and Victoria have now expressed the view that a superintendent's certificate that involves the exercise of a discretion cannot be reopened by an arbitrator just because it is wrong.

Secondly, by providing a discretion in the assessment process, the parties might be presumed to have agreed that a superintendent's certificate is 'final and binding'; in other words, express words are unnecessary for the certificate to have that effect.

In *Dura*, a number of arguments were in fact made that the parties had not intended that the certificate would be final and binding. First, it was pointed out the



superintendent was an agent for the principal. It was submitted that, in that circumstances, 'it was unlikely that the parties had intended to make the certificate final and binding'.²⁶

In considering that issue, Maxwell P quoted the judgment of Lord Hoffman in *Beaufort Developments* where an architect's certificate was held not to be final and binding. Lord Hoffman had recognised the reasons why the parties would not have intended the certificate to have that effect in the following terms:²⁷

'to make the certificate conclusive could easily cause injustice. It may have been given when the knowledge of the architect about the state of the work or the effect of external causes was incomplete. Furthermore, the architect is the agent of the employer. He is a professional man but can hardly be called independent. One would not readily assume that the contractor would submit himself to be bound by his decisions, subject only to a challenge on the grounds of bad faith or excess of power. It must be said that there are instances in the 19th century and the early part of this one in which contracts were construed as doing precisely this. There are also contracts which provided that in case of dispute, the architect was to be arbitrator. But the notion of what amounted to a conflict of interest was not then as well understood as it is now. And of course the inclusion of such clauses is a matter for negotiation between the parties or, in a standard form, the two sides of the industry, so that what is acceptable will to some extent depend

upon the bargaining strength of one side or the other. At all events, I think that today one should require very clear words before construing a contract as giving an architect such powers.'

The decision in *Beaufort Developments* is followed in England. In order to oust the jurisdiction of the court (or an arbitrator) to open up a certificate of a superintendent, the terms of the contract must be unequivocal and clear. If not, a court is unlikely to find the parties intended to exclude access to the courts to review a certified fact.²⁸

However, in *Dura*, the Court expressly rejected *Beaufort Developments*, followed the decision in *WMC* and quoted the principles that Ipp J had set out. In doing so, the Court adopted what was said to flow from the agreement of vesting the superintendent with a discretionary certification power.

The Court in *Dura* considered and followed the judgment in *WMC* as to what is a 'discretionary judgment':

'There may be several possible methods of ascertaining value, each giving widely different results, but each being reasonable. Many subsidiary factors relevant to the valuation may be uncertain, many contingencies may have to be taken into account, wide ranges of legitimate decisions may apply, and opinions may legitimately differ as to virtually all of the relevant issues.'²⁹

In the author's view, there is unlikely to be any decision of a superintendent



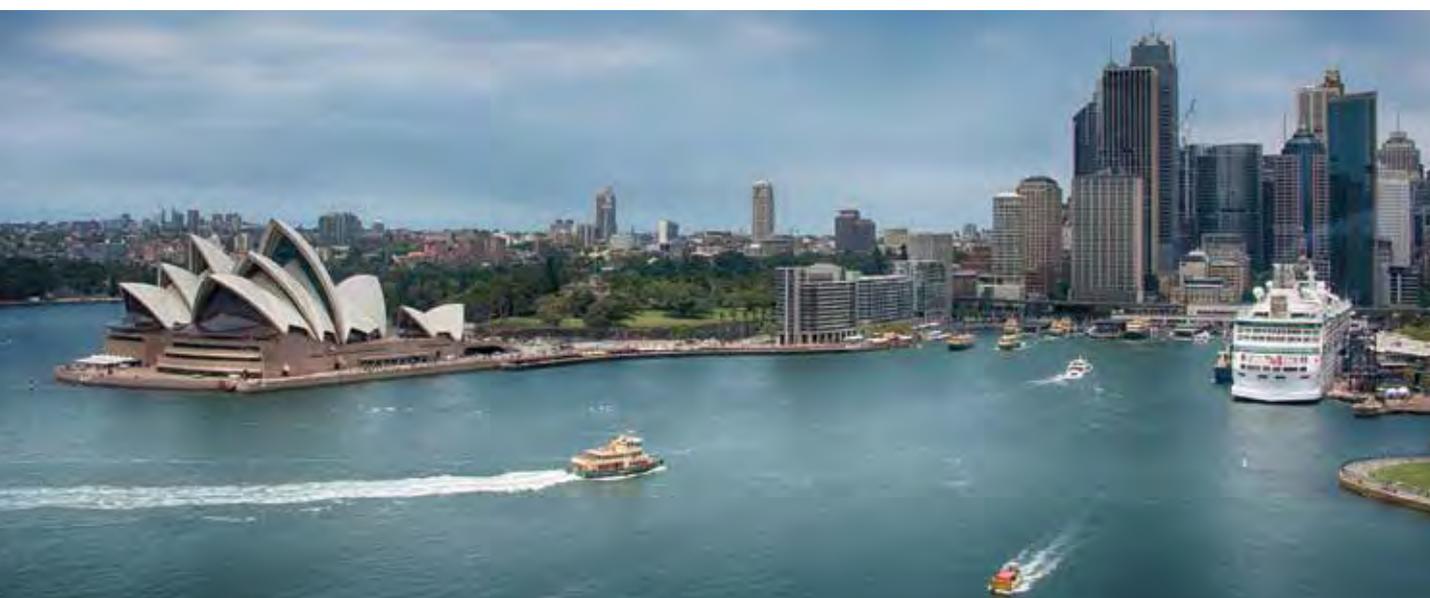
ever made that does not answer that description. Indeed, that is why parties appoint superintendents to administer building contracts in the first place.

In the real world, contractors may be genuinely surprised to find that, by agreeing that a superintendent (much less a principal) has a discretion in certification, they are also agreeing that the thing certified cannot be reviewed on the merits. As was held in *Beaufort Developments*, there are very good reasons why certificates issued (particularly during the progress of the works) should not in modern law be construed to be final and binding under the terms of the contract without very clear words to that effect.

Notes

- 1 'Expert evidence: trials, perils and pitfalls' (2013) 7(4) CLInt 36. The decision was *Dura (Aust) Constructions Pty Ltd v Hue Boutique Living Pty Ltd (No 3)* [2012] VSC 99, a judgment of Dixon J.
- 2 [2013] VSCA 179.
- 3 (2000) 16 BCL 53.
- 4 [1999] 1 AC 266.
- 5 *Ian Delbridge Pty Ltd v Warrandyte High School Council* [1991] 2 VR 545.
- 6 (2000) 16 BCL 53, [33].
- 7 (2000) 16 BCL 53, [33].
- 8 (2000) 16 BCL 53, [34].
- 9 See, for example, I N D Wallace, 'In its sole discretion: an unpersuasive interpretation?' (2000) 16 BCL 243.
- 10 In *WMC*, Ipp J considered the possibility the valuation provision 'in its sole discretion' was void for uncertainty and held that 'any uncertainty would be cured by the implication of terms requiring the appellant to value by reference to objective criteria', which included the requirement of reasonableness ((2000) 16 BCL 53, [46]). See Michelle Backstrom, 'An examination of the independent certification process of a construction contract' (2013) 29 BCL 406.
- 11 [1984] QB 644.
- 12 *Crouch* at 664.
- 13 See, for example, *Bond Corp Pty Ltd v Thiess Contractors Pty Ltd* (1988) 17 FCR 487.
- 14 See, for example, I N Duncan Wallace, 'RIP *Crouch*: an un mourned demise' (1998) 14 BCL 441.
- 15 *Gilbert-Ash (Northern) v Modern Engineering (Bristol) Ltd* [1974] AC 689.
- 16 *Dura (Aust) Constructions Pty Ltd v Hue Boutique Living Pty Ltd (formerly SC Land Richmond Pty Ltd) (No 3)* [2012] VSC 99, [621].
- 17 [2012] VSC 99, [623].
- 18 [2004] VSC 225.
- 19 [2009] QCA 102.
- 20 [2012] VSC 99, [631].
- 21 [2013] VSCA 179, [15].
- 22 In critically reviewing *WMC*, Backstrom (see note 10 above, at 413) suggests: 'Rather than focusing on whether the decision may be labelled an exercise of discretion, the better approach would be to focus attention more broadly on an analysis of the parties' intention expressed in the contract, its terms, and whether the discretion complies with them. If the decision is in accordance with the terms of the contract, the conclusion would be there is no breach of contract, no dispute as defined above and therefore the certificate would not be subject to challenge.' With respect, that analysis confuses what is being assessed with the finality of the assessment. In this author's view, a valid certificate under a contract can be wrong as to the fact certified. Conversely, a challenge to a correct assessment of the fact in issue, should be dismissed, but it should be dismissed because it is correct, not because the parties intended the discretionary decision of the superintendent to be final and binding. Further, in this author's view, an incorrect certificate of a superintendent does not fit comfortably as a 'breach of contract' by the principal under most building contracts, notwithstanding that is often the way cases are pleaded.
- 23 [2013] VSCA 179, [18].
- 24 (Referenced cases omitted).
- 25 [2013] VSCA 179, [18] (referenced cases omitted).
- 26 [2013] VSCA 179, [35].
- 27 [1999] 1 AC 266, 276, cited at [2013] VSCA 179, [35].
- 28 See, for example, *Henry Boot Construction Ltd v Alstom Combined Cycles Ltd* [2005] EWCA Civ 814.
- 29 [2013] VSCA 179, [20], quoting with approval from *WMC* at [23].

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