TYING UP LOOSE ENDS, AND DISPUTE RESOLUTION, IN ICT CONTRACTS: QUICKER, SIMPLER AND BETTER SOLUTIONS?

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There is plenty of ground for difference of opinion under IT contracts. If things have to go all the way to arbitration, there's lots of delay, and, in the meantime, urgent decisions may be needed on projects, particularly those that are complex and expensive. There are alternatives for quicker solutions and we summarise these in our paper.

Anything beyond informal resolution of disputes can be ugly. But quick fire expert determinations or arbitrations could be faster, cheaper and less divisive.

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1. Introduction

1.1 ICT Contracts typically use litigation or arbitration for dispute resolution. But particularly for complex projects, litigation is expensive and lengthy, and will quickly destroy whatever relationship still remains between supplier and customer. And judges usually aren’t specialised in technology issues.

1.2 The other alternative – arbitration – generally takes place under our 1996 Arbitration Act. The standard arbitration model (which is typically selected for ICT contracts) has many of the characteristics of Court litigation. There’s formality, exchange of pleadings, discovery (the process by which parties exchange documents between each other), a formal hearing, and so on. But at least the arbitrator is likely to be specialised in ICT matters. Arbitration can still be as expensive and time consuming as Court. And normal arbitration isn’t good at resolving issues while the project is running, when quick decisions are desirable, and people want to preserve relationships.

1.3 Quite apart from the excellent driver of resolving disputes quickly and cheaply, some issues ideally should be sorted out practically. During a
software development project, it would be great for the parties to know quickly whether for example the work done by the supplier meets the specifications and/or acceptance test criteria. An easy way of resolving price when this is uncertain (as often happens in projects) would be great. And so on.

1.4 Are there alternatives? Yes there are, but they come at the expense of having a more rough-and-ready decision making process. This compromise is something many parties are prepared to accept simply to speed up the process and reduce cost. In England for example, more and more use is made of the expert determination procedure. This is essentially a toned down version of fully fledged arbitration. This can be used in many fields. By way of example, when the Chairman of the UK professional body for valuers is asked to appoint someone to resolve disputes, only half will be arbitrators. The rest are appointed as experts to do an expert determination. Similarly, for accountants, around 30% of appointments are for arbitrators and 70% for experts.¹

1.5 Recent decisions help clarify the approach to expert determination in New Zealand matters. But some uncertainty remains. In this paper we outline the position and float some new solutions to old problems.

2. What is Expert Determination?

2.1 There can be some confusion partly because:

2.1.1 arbitrations these days can in fact be rapid-fire and relatively informal (see more about this below); and

2.1.2 there can be confusion between the (a) the roles of valuers (eg: those that value the rent of a commercial lease when it can’t be agreed) and, (b) experts and arbitrators.

2.2 Broadly, arbitrators (who proceed under the Arbitration Act 1996) decide things a bit like a judge decides. They do so applying natural justice, following a full hearing and other procedural steps. While the theory is that they don’t make the decision applying their own knowledge, in fact, in most arbitrations under the Act, they are expressly permitted to do so now by statute.

2.3 Making the decision from their own knowledge is something that experts are expected to do, and they are not necessarily required to follow natural justice principles. In this way, the expert determination can be quicker and involve less procedural steps. Importantly, much depends on what the contract says. For both expert determination and arbitration, the parties can pre-determine much of what happens.

¹ J Kendal, Expert Determination (3rd Edition), Sweet & Maxwell Para 11.5.3
2.4 Historically, expert determination tended to be used for decisions on technical matters and/or decisions which did not involve multiple issues. However, increasingly, expert determination is moving into issues involving not only technical matters but also commercial and legal issues.

2.5 This is a developing area so we’ll set out some of the issues, risks and solutions.

3. **Advantages of Expert Determination**

3.1 As the Arbitration Act doesn’t apply, the process can be less formal, quicker and cheaper. The expert can use his or her own expertise, make enquires and then make the decision. Contractually, the right to appeal can be limited. The expert will want however to limit his or her liability (the automatic protection under the Arbitration Act would not be available).

3.2 Steps such as exchanging pleadings, disclosing documents to each other, and even hearing any kind of submissions from the parties, can be avoided if desired. This can change resolution of a dispute from months or years down to even days in optimally set-up situations. Say for example the parties contract for independent verification (by an expert) as to fulfilment of acceptance tests. The project is ongoing and they want a quick answer. Sure, getting this done quickly is more risky, but the benefits of speed and reduced cost greatly outweigh that risk. This situation (not so much resolving a dispute but deciding in advance how an issue will be covered), is classic expert determination territory.

4. **Negatives of Expert Determination**

4.1 Because it can be “quick and dirty”, obviously there is more chance of getting it wrong. But this may be a price worth paying. Drawn out, expensive and divisive arbitration or litigation is a lousy option. There is a definite risk though. Take discovery as an example. This is a time consuming and expensive process in both litigation and arbitration. It requires the parties to disclose to each other the documents (confidential or not) that will either advance or prejudice their cases. In most disputes, one party stands to gain a lot more from discovery than the other. Lack of discovery can be a real prejudice to the most affected party. But the time and cost involved in discovery may mean that it is worth both parties compromising for a more rough, ready and quicker resolution.

4.2 Depending on how the dispute resolution clauses are agreed, both expert determination and arbitration give certain but differing appeal rights. However, while there is always the risk of appeal, these rights can be limited to give greater and quicker finality\(^2\). However, there probably is a

\(^2\) With arbitration, the initial contract can make the arbitrator’s award final and binding and therefore subject to appeal in fewer circumstances. The circumstances in which there can be appeals are set out
greater risk that the process can be attacked with expert determination but
again this can be minimised by optimal drafting.

5. **How do you pick disputes suitable for Expert Determination?**

5.1 Parties often would only want some of their disputes to go to expert
determination, with others going to arbitration. They may seek to
distinctly *technical* decisions from *legal and commercial* decisions. A
problem however is that it is very rare for disputes to be capable of being
neatly pigeon holed like this. Take the example of a problem that arises in
many software development agreements. The supplier contracts to
develop an application, not knowing the full structure of the application at
the end and therefore not being able to agree acceptance testing criteria
with the customer. Neither party should get in this situation (there are
other solutions). But it happens all the time. It is possible to say in an
agreement that a third party expert will determine the acceptance testing
criteria (and compliance) in due course if the parties can’t agree. Setting
up a mechanism for determining an unresolved issue such as price,
acceptance testing criteria etc, is one way in which an uncertain agreement
(which would be unenforceable at law) can be made certain. As long as a
mechanism is put in place to do this, the Courts will enforce if it is
capable of being worked through objectively. If the parties are prepared
to put matters into third party hands, allowing an independent expert to set
the price for the software development project when it is finished is a
great solution for the related difficult problem of pricing a project, the
path of which is not clear at the outset. This is a big problem area in
relation to software development and one in which, in our experience,
both suppliers and customers can take way too much risk.

5.2 But one option is to have a third party to set the price. Information and
criteria can be provided in the initial contract to assist the expert with the
setting of price.

5.3 The complex process of setting acceptance testing criteria can also be
devolved to an expert. But note that, like price in a complex IT situation,
this is not just a matter of an expert working out certain technical
requirements. This decision has strong involvement of commercial and
legal issues too. To determine acceptance testing criteria requires

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in *Gold and Resource Developments (NZ) Limited v. Doug Hood Limited* [2000] 3 NZLR 318 (CA). The flexible principles upon which there can be appeals are unlikely to be changed by legislation following the February 2003 Law Commission report, *Improving the Arbitration Act 1996*. To minimise the risk of a technical argument on the “final and binding” wording, it is prudent to confirm also in the arbitration clause not only that the award is final and binding but, so far as possible, there can be no appeal. See the analysis in *Improving the Arbitration Act 1996* at paras 111-113. If the Law Commission’s report is adopted as to appeals on perverse findings of fact, it will be confirmed in amending legislation that the ability to appeal on this ground alone should be limited (by excluding from “error of law” perverse findings of fact (see the Law Commission’s report at para 125)).

3 By avoiding the problem of differentiating the types of claims to be covered by expert determination, as noted below.

4 See *Attorney General v. Barker* (NZCA).
assessment of the requirements of a lengthy and complex contract, coupled with specifications and so on. Both supplier and customer can have very different ideas as to what suitable acceptance testing criteria would be at the point when they come to be determined. At its simplest level, a supplier may lean more towards criteria based on functionality with a customer heading more towards criteria based on business outcomes. Things are much more complicated than that. So what is at first sight a technical issue rapidly becomes one which is one of some complexity, raising many issues outside the technical arena.

5.4 While an expert can be given guidelines at the outset to reduce risk of a strange decision, it can be seen that, for both supplier and customer, leaving acceptance testing criteria until later (to be decided by an expert) involves risk. But maybe the risk is better than other alternatives?

5.5 To have such decisions resolved in a normal arbitration environment would take way too long and would be unwieldy. Not to have a mechanism to sort things out can leave one or other of the parties at a disadvantage. Expert determination enables these decisions to be made quickly (provided the situation is well set up) and in a way which should minimise or should encourage the parties in continuing to work together.

6. Other uses of Expert Determination

6.1 There is increasing use, at least in the UK, of expert determination, for all manner of disputes. It’s a process strongly supported by acceptance of that approach by the highest Court there, even in complex situations.\(^5\) If the issues are too complex though, expert determination may be too risky for the parties and in any event may not be acceptable to our NZ Courts, as noted below. Decisions for example on when a contract has been breached, and the damage payable for that breach, can involve substantial sums, and therefore the parties may want the more reliable arbitration procedure (or litigation) in those situations.

6.2 So expert determination could be more suitable for resolving issues such as: compliance with acceptance testing criteria, determining periods and breaches for liquidated damages (or rebates under service levels), and so on. It may be suitable for situations such as determining price at the end of a contract, having a compulsory process for change control (rather than a voluntary one as is currently the situation), determining acceptance testing criteria, and resolving various technical issues during the course of a project.

7. How do you differentiate disputes for experts from others?

7.1 One of the problems is to distinguish between disputes to go to expert determination and disputes to go to arbitration or litigation. Just as even

the most technical of issues can often involve wider commercial and legal issues, there can be a problem in distinguishing this. A clause that simply provides for a distinction between technical and other disputes raises a high risk of a preliminary dispute between the parties as to whether the dispute is “technical” and governed by the expert or the arbitration process. Such an approach is too risky, unless there is a solution, such as the parties agreeing in advance that it is for the expert absolutely to determine whether the dispute is technical or otherwise.

7.2 Typically when a dispute arises, one party may be pushing for a particular process (eg: expert determination) and the other party may be doing all it can to stand in the way. One commentator on expert determination in IT contracts takes the view that it is best not to agree expert determination upfront. He’d rather to leave choice of the process to be agreed between the parties when the problem arises. When there is a dispute, they can choose if they want it to go to expert determination. While that sounds great in theory, in practice it would be rare for both parties to agree for the matter to go to expert determination after the problem has arisen. We wouldn’t rely on that approach.

7.3 Another solution is to use expert determination for all disputes. But there’s a heightened risk that arbitration will be imposed anyway (see below). And the expert determination could lead to a perverse result in some cases.

7.4 A good option is to specifically provide for expert determination in particular categories. This is probably the best approach. It could be agreed that it be used for example for determining LD periods, rebates for service levels, compliance with acceptance testing criteria, change control, payment dates, benchmarking of prices and services, and so on.

7.5 This raises a further option which could be hijacked by the IT industry from the building industry (as so many concepts and ideas have been and continue to be hijacked). The building industry equivalent of critical milestone dates, fulfillment of acceptance testing criteria, LD periods, rebates under service levels and so on, are frequently determined by an architect or engineer appointed by the employer. Typically, that decision is reviewable under arbitration, but until then it stands. Particularly in large projects, such an independent certifier can be appointed, whose rule is similar to that of an expert.

8. **Uncertainty: is Expert Determination governed by the Arbitration Act?**

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8.1 While recent cases are increasingly taking a stronger approach to the contrary, there is a 1991 Court of Appeal decision (re Dickinson) which points to expert determination being governed by the Arbitration Act (and all its rigours). This is the case more than applies overseas. In that case, there was a typical expert determination clause which noted that the expert would resolve the dispute as an expert not as an arbitrator. While the Court of Appeal decided this was an arbitration primarily on the basis of the then arbitration legislation (which no longer applies), it was also said that there was be an arbitration in part because:

8.1.1 The expert determination clause said that the expert must have due regard to evidence submitted by the valuers appointed by each party. This is one of the hallmarks of arbitration namely, that natural justice applied and regard is had to evidence submitted); and

8.1.2 The dispute in fact was being resolved in a way which resembled an arbitration with a formal hearing. There were lawyers acting for both parties and so on.

8.2 As to that first point (the obligation to take into account the valuers’ evidence), decisions overseas (including subsequent decisions from England’s highest Court in the Channel Tunnel case) point convincingly away from that conclusion. And there are other High Court of New Zealand decisions to similar effect. As to the second point, the Court was making that point based on the events taking place after the original clause was agreed between the parties. The point could be decided differently under the later 1996 Act. Whether or not the Arbitration Act 1996 applies depends on whether there is an “arbitration agreement” (ie: an agreement by which there would be an arbitration). “Arbitration” is – in effect – not defined. Therefore, under the new legislation, unless there is a fresh arbitration agreement after the initial agreement (and that fresh arbitration agreement contained terms as to the form of hearing and so on), this limb of the decision would not apply under the new Act.

8.3 While the Forestry Corporation decision distinguished the Dickinson decision and there are the grounds of distinction noted above, the case throws some uncertainty on whether expert determination clauses in particular circumstances are subject to the Arbitration Act. However, the

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8 [1992] 2 NZLR 43.
9 See Section 19 Arbitration Act 1996.
10 See Section 2 Definition of “Arbitration”. There is no particular guidance on the definition in the model UNCITRAL Rules from which the Act is derived.
authorities generally are moving firmly toward accepting expert
determination can be undertaken outside the Arbitration Act.

8.4 Note anyway that whether or not an expert determination clause is
covered by the Act is not determined solely by the fact that the parties say
that the decider is an expert not an arbitrator, although that is strong
evidence. The Courts take into account a number of points in deciding

8.5 To minimise the risk of a perverse decision by an expert, it’s best to have
the expert get submissions from the parties, at least at some level (eg in
writing). But the \textit{Dickinson} decision suggests that setting out such a
requirement in the clause may lean things towards an arbitration rather
than expert determination even if the parties say its expert determination,
not arbitration. It may be simpler not to define the procedure and to add,
as happened in the \textit{Forestry Corporation} case, confirmation that the
expert’s decision is final and binding (this was a point on which that Court
relied on to distinguish \textit{Dickinson}). Another alternative is to set out the
procedure for expert determination in more detail and take the risk that the
Arbitration Act will apply (it may be safer to run that risk rather than take
the risk of having little or no defined procedure). A further option is to
use expert determination to decide pre-determined issues (eg: price)
rather than a “dispute” which is more likely to come under the Arbitration
Act. The distinction is narrow and legally technical though.

9. \textbf{Take the Arbitration route anyway?}

9.1 Depending on the circumstances, maybe the best approach is to accept
that there is an arbitration and the Arbitration Act applies anyway. There
is some good news in this approach:

9.1.1 The Arbitration Act contains very useful processes for dispute
resolution which can protect the parties and lead to a better result.
For example third parties can be required by Court order to give
evidence. The Arbitrator’s award is directly enforceable by the
Court (an expert determination requires the successful party to go
through more hoops and there is more risk). Additionally, in
practice, the arbitration process is well understood in New
Zealand. There’s relatively little New Zealand experience with
expert determination except in some specific areas.

9.1.2 One of the great advantages of the expert process is now
available to arbitrators. The expert can use his or her own
knowledge and expertise and can take an inquisitorial approach
(ie, he or she doesn’t just have to rely upon the evidence as presented by the parties).  

9.1.3 The Arbitration Act allows the parties to contract out of many of the “belt and braces” requirements of the Act. This includes for example the right ability to contract out of the obligation to disclose documents to each party (a particularly expensive and time consuming part of the process). An extreme example of this is the longstanding and so called “look-sniff” arbitration common in the London commodities market. The English have similar arbitration legislation to ours. One practical variation of the arbitration model is that an arbitrator can inspect a sample of goods (say, cocoa beans) and determine its quality and price, based solely on his or her own expertise and knowledge, and without any submissions by any of the parties. Parties to an IT contract can contract to do something between a fully fledged arbitration (with all its cost and delay) and such a rudimentary look-sniff arbitration. Set up optimally (and particularly if the arbitrator is appointed in advance or there is a mechanism by which he or she can be appointed quickly). This could produce a decision (binding in the majority of cases) within days or even weeks.

9.1.4 In this way the Act might work OK in relation to an ongoing contract. Often there is so much at stake in IT contracts that it may be better to take this approach rather than an approach which has a rudimentary expert determination clause with little procedural detail.

10. Mediations, Options, and the Practical Reality

10.1 While IT and other contracts rarely go to appointment of an arbitrator or issue of Court proceedings, having the ability to do so can be conducive to early resolution of disputes. It is always far better to try and resolve disputes before things get to that stage. So a dispute resolution clause is important, escalating from discussion between project managers to discussion between senior managers and so on. To back up this procedure, the clause may explain the reasons for speed and make it clear directly or indirectly that the benefit of quick (yet imperfect) resolution overrides the detailed arbitration procedures. Having a requirement to go to mediation is a great option.

11. Conclusion

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12 See Arbitration Act 1996 Schedule 2, Clause 3 (a) and (b). Like many provisions in the Act, the parties can contract out of these provisions. Specific attention is needed anyway in relation to international arbitrations. Standard arbitration clauses don’t contract out of clause 3.

13 See Arbitration Act 1996 Schedule 2, Clause 3 (1) and 3 (1)(f). For a useful list of the ways in which the parties can agree to vary the Arbitration Act’s requirement see para D2.07 in Brooker’s Arbitration Law & Practice by Green and Hunt.

14 See Kendall, Expert Determination (3rd ed.) at para 2.33.
11.1 Anything beyond informal resolution of disputes can be ugly. But quick fire expert determinations or arbitrations could be faster, cheaper and less divisive.

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