

SOLE DISCRETION REVISITED:
WMC Resources Ltd v Leighton Contractors Pty Ltd
[1999] WASCA 10

INTRODUCTION

It is not uncommon for parties to a contract to include a term that if the parties cannot agree on a course of action, then one of the parties shall '*in its sole discretion*' determine the course of action.

Parties to a mining contract agreed on a term of this type in a case that recently came before the WA Supreme Court¹ The parties in the case were *WMC Resources Limited* ('WMC') and *Leighton Contractors Pty Ltd* ('Leighton').

Under the contract Leighton undertook to carry out open pit mining for WMC at WMC's nickel mine at Mount Keith in Western Australia. The contract provided that, subject to certain conditions (which were not in issue), WMC was entitled to direct Leighton to vary the volumes to be mined. A term of the contract also provided that the value of any variation was to be determined by WMC in accordance with the schedule of rates in the contract, or if the schedule was not appropriate, then the value of the variation was to be agreed between the parties. If the parties were unable to agree the value, the contract provided that the value be determined by WMC '*in its sole discretion*'.

On several occasions in 1995 and 1996, WMC directed Leighton to vary the volumes to be mined. The parties could not agree on the value of the variations and in its sole discretion WMC determined the value of the variations. Leighton disputed WMC's valuations and in June 1997, pursuant to an arbitration clause contained in the contract, Leighton commenced arbitration proceedings contending that WMC had 'failed to exercise its discretion in a way which [was] ... authorised by the contract'. Leighton sought to have the arbitrator determine the value of the variations.

In May 1998, the matter was referred under section 39(1)(b) of the *Commercial Arbitration Act 1985* (WA) to a judge of the Supreme Court

1 *WMC Resources Ltd v Leighton Contractors Pty Ltd* (unreported) WA Supreme Court (BC 9804601 10 September 1998) per Anderson J; *WMC Resources Ltd v Leighton Contractors Pty Ltd* [1999] WASCA 10; BC9902536

seeking the determination of several points of law arising in the course of the arbitration. Formal questions were put to the judge at first instance as to the basis by which the value was to be determined and as to whether the arbitrator could substitute his own decision for that of WMC. The judge made a finding with respect to the meaning of the words '*in its sole discretion*'. This case note sets out the findings of the trial judge on these issues and then addresses the subsequent overturning of the trial judge's findings by the Full Court on appeal

TRIAL JUDGE'S FINDINGS²

The trial judge was asked to determine several questions of law, including:

1. Whether, and to what extent, the basis upon which the value may be determined is affected by the provision that the valuation by WMC is to be made '*in its sole discretion*'; and
2. Whether and to what extent, the arbitrator has the power to substitute his own valuation for the valuation made by WMC

The trial Judge answered both the questions by stating:

The power conferred on [WMC] to determine the value of the variation in its sole discretion does not confer a power on [WMC] to make a conclusive determination of [Leighton's] right to payment. In the event of a dispute the arbitrator may himself determine the value of the variations

The trial judge found that the term '*in its sole discretion*' could not be read as conferring a discretionary power on WMC to make a conclusive and unreviewable determination on the amount of payment to a contractor, as to do so, would seriously undermine the commercial nature of the contract. Having reached this finding the trial judge went on to find that an arbitrator did have the power to determine the value of the variation and substitute WMC's determination for his own

APPEAL COURT'S FINDINGS³

In October 1998, WMC lodged an appeal against the trial judge's finding in relation to the meaning of the words '*in its sole discretion*'. WMC submitted that the words '*in its sole discretion*' meant that WMC's valuation was binding and conclusive and could only be challenged in circumstances where it could be shown that WMC did not act honestly, bona fide and reasonably in determining the valuation.

2 *WMC Resources Ltd v Leighton Contractors Pty Ltd* (unreported) WA Supreme Court (BC 9804601, 10 September 1998) per Anderson J

3 *WMC Resources Ltd v Leighton Contractors Pty Ltd* [1999] WASCA 10; BC9902536

On 7 May 1999, the Full Court of the Western Australian Supreme Court allowed the appeal and overturned the trial judge's finding on this issue. The Full Court held that:

- The determination of the value of the variation was a discretionary determination and therefore it could not be set aside merely because it was said to be incorrect;
- The valuation could only be interfered with if it was not made in accordance with the terms of the contract;
- In determining the value, WMC was required to act honestly, bona fide and reasonably;
- In the absence of an increased or express power on the part of the arbitrator in the contract, there was no reason to believe that WMC's valuation was not final and binding;
- The proposition that WMC's valuation was provisional had no application to the task of determining a valuation under the relevant clause in the contract;
- The parties had agreed that, if in dispute, WMC would determine the value. This was an important consideration for entering into the contract. By the ordinary principles of the law of contract Leighton was, subject to the other provisions in the contract, bound by WMC's valuation as long as it was given in accordance with the terms of the contract;
- Even without the phrase '*in its sole discretion*', the very nature of the valuation task undertaken by WMC could only be challenged on the grounds that it had failed to act honestly, bona fide and reasonably or on the grounds that it failed otherwise to act within the terms of the contract; and
- Only if WMC's valuation were set aside on proper grounds then would it be open to the arbitrator to substitute his valuation

In reaching its finding the Full Court found that the term '*in its sole discretion*' should be given its ordinary meaning. The Court recognised the need for discretionary judgments in valuations particularly those involving variations on mining works. Of course this finding does not mean that a party responsible for such value judgments can do so without adherence to proper principles of good faith, honesty and reasonableness. Where a valuation is made which fails to apply these principles the contract itself, through its arbitration clause, provides a means of recourse to the other party in ensuring these principles are applied to any valuation.

The Full Court's decision recognises and upholds the important contractual principle that parties entering freely into commercial

contracts do so with the expectation that they will be bound to the terms agreed upon and contained within the contract

Nicholas Rohr
Barrister and Solicitor
Supreme Court of Western Australia