expert matters

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The counsel of perfection

Morris v Danoz Directions Pty Ltd (in Liquidation) (No 2) [2010] FCA 836 (10 August 2010)

Summary

It is now well established, through principles set out in the *Makita* case[1], that if evidence tendered as expert opinion evidence is to be admissible, it must (amongst other things) be agreed or demonstrated that there is a field of "specialised knowledge" and the opinion proffered must be "wholly or substantially based on the witness's expert knowledge".

However this case, and other cases dealing with expert evidence, makes it clear that the *Makita* principles are a *counsel of perfection*. As Sydney Forensics partner John Temple-Cole discusses, a Court may find an expert's evidence admissible, notwithstanding that it "strictly speaking" does not live up to *Makita* principles. However, an expert's report with such failings would appear to run an increased risk of being given little, if any, weight by the Court.

Background

This case concerned the purchase by the applicants (members of the same family) of a number of franchises from Danoz in 2003-4, to run retail stores to be known as "Danoz Directions". The applicants alleged that they were told a number of matters by Danoz (and by a number of its officers), that they were induced by those statements into buying the franchises and that the statements were misleading and deceptive and therefore contrary to s52 of the Trade Practices Act 1974 (Cth).

The applicants alleged that the Danoz representations included that "the business of Danoz Directions was on a growth path", and claimed damages from several of the officers of Danoz who they claim were knowingly involved in the making of the representations.

The fourth respondent, TVN, conducted a direct television marketing business involving the marketing of retail consumer products on popular daytime television programs and by means of "infomercials". Consumers were able to telephone a call centre and acquire the products using a credit card.

The franchises bought by the applicants were intended to be a retail complement to that structure, to capitalise on customers who "liked to touch or feel a product before purchasing or who did not have a credit card." Justice Perram noted that the constant flow of ever-changing products included the likes of carrot slicers, button sewers and the 'AbTronic' which he described as "a device said to improve the state of a consumer's abdominal muscles by using electric currents and requiring little effort on the consumer's part to achieve visually pleasing results".

Expert evidence as to solvency

The applicants commissioned two reports from an expert accountant, Mr B, which sought to demonstrate that Danoz Directions and TVN were "close to insolvency" in the 2004 financial year. The second report in reply was prepared in response to a statement, with supporting documents, filed by Danoz seeking to demonstrate its financial health.

Mr B's opinions included that:

> *Danoz Directions was not on a growth path because Danoz Directions and the remaining entities forming the Danoz Group were close to insolvent.*

"The strict application [of *Makita*] might well lead to the conclusion that this [evidence] would be inadmissible.

However, the prevailing view is that [the *Makita*] dictum is a counsel of perfection..."

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Justice Perram mentioned the expert's training, qualifications and experience which included membership of the Institute of Chartered accountants in Australia. However, his training and work experience "did not include any special qualifications in insolvency work".

Objections to the expert evidence

There was substantial debate concerning the admissibility of certain aspects of Mr B's evidence which Justice Perram distilled into eleven points. A number of these are discussed below.

Objection relating to use of list of insolvency indicators

Mr B's first report identified that the factors he had had regard to in considering the question of solvency included the "key indicators of insolvency" as summarised in the Australian Securities and Investments Commission (ASIC) Information Sheet 42 "Insolvency: A Guide for Directors". However, his report went on to deal with only six of the key indicators included in that guide.

Counsel for Danoz objected on the basis that the utilisation of a list published by ASIC did not involve the application of any expertise. Justice Perram rejected this, noting that:

> *...the factors appearing on the ASIC checklist are commonsense indicators of insolvency. I do not see why an expert accountant needs to explain his reasons for thinking that generally the presentation of statutory demands to corporations can be an indicia of insolvency.*

More relevantly to *Makita* principles, Counsel also objected on the basis that "it was not explained why some elements from the ASIC list had been used and not others." Again, Justice Perram rejected this argument:

> *It is true that Mr [B] does not explain clearly why it is that he has selected only the six factors that he has from the larger list in ASIC's document. The strict application of the dictum of Heydon JA in Makita[1]...might well lead to the conclusion that this aspect of Mr [B's] report would be inadmissible [Sydneywide Distributors Pty Ltd v Red Bull Australia Pty Ltd[2]]. However, the prevailing view is that that dictum is a counsel of perfection...*

The particular paragraph of *Makita* referenced above by Justice Perram is, out of the many judgments dealing with expert evidence, perhaps the most relevant and frequently cited guiding principle for experts. It is included in full in the "Makita Principles" box to the right.

Justice Perram further noted that in Sydneywide Distributors Weinberg and Dowsett JJ also analysed Heydon JA's dictum and placed particular emphasis upon the use of the words "strictly speaking":

> *The use of the phrase "strictly speaking" ... should not be overlooked. It may well be correct to say that such evidence is not strictly admissible unless it is shown to have all the qualities discussed by Heydon JA. However, many of those qualities involve questions of degree, requiring the exercise of judgment. For this reason it would be very rare indeed for a court at first*

Makita Principles

In short, if evidence tendered as expert opinion evidence is to be admissible:

- it must be agreed or demonstrated that there is a field of "specialised knowledge";
- there must be an identified aspect of that field in which the witness demonstrates that by reason of specified training, study or experience, the witness has become an expert;
- the opinion proffered must be "wholly or substantially based on the witness's expert knowledge";
- so far as the opinion is based on facts "observed" by the expert, they must be identified and admissibly proved by the expert, and so far as the opinion is based on "assumed" or "accepted" facts, they must be identified and proved in some other way;
- it must be established that the facts on which the opinion is based form a proper foundation for it; and
- the opinion of an expert requires demonstration or examination of the scientific or other intellectual
  basis of the conclusions reached: that is, the expert's evidence must explain how the field of "specialised knowledge" in which the witness is expert by reason of "training, study or experience", and on which the opinion is "wholly or substantially based", applies to the facts assumed or observed so as to produce the opinion propounded.

If all these matters are not made explicit, it is not possible to be sure whether the opinion is based wholly or substantially on the expert's specialised knowledge. If the court cannot be sure of that, the evidence is **strictly speaking** not admissible, and, so far as it is admissible, of diminished weight.

And an attempt to make the basis of the opinion explicit may reveal that it is not based on specialised expert knowledge, but, to use Gleeson CJ's characterisation of the evidence in HG v R [1999] HCA 2; (1999) 197 CLR 414, on "a combination of speculation, inference, personal and second-hand views as to the credibility of the complainant, and a process of reasoning which went well beyond the field of expertise".

[emphasis added]

Source: Makita v Sprowles[1]

> *instance to reach a decision as to whether tendered expert evidence satisfied all of his Honour's requirements before receiving it as evidence in the proceedings. More commonly, once the witness's claim to expertise is made out and the relevance and admissibility of opinion evidence demonstrated, such evidence is received. The various qualities described by Heydon JA are then assessed in the course of determining the weight to be given to the evidence. There will be cases in which it would be technically correct to rule, at the end of the trial, that the evidence in question was not admissible because it lacked one or other of those qualities, but there would be little utility in doing so. It would probably lead to further difficulties in the appellate process.*

In conclusion, Justice Perram rejected the objection, noting that the above approach to Makita was approved by the Court of Appeal in *Adler v Australian Securities and Investments Commission*[3], a position repeated in *Paino v Paino*[4]:

> *In those circumstances, whilst noting that Mr [B] has not explained why he alighted upon the six factors from the ASIC list that he did, I propose, at this stage, to admit the evidence.*

Objection that process of reasoning not disclosed

Mr B's first report included an analysis of assets and liabilities for the purposes of establishing whether there was an excess of the latter over the former, being one of the insolvency indicators to which he had referred. This showed a fluctuating net asset position in 2004, leading to an opinion that:

> *Given the above analysis, in my opinion, the satisfaction of this test is a weak indicator that the Danoz Group was not insolvent or close to insolvency for the period September 2003 to March 2004.*

Counsel's objection related to the absence of an explanation as to why the indicator was "weak" and that it is hard to understand why its success in passing this asset/liability test had been discounted in this way, when emphasis had been given to Danoz's failure to pass other tests . He submitted that this underscores a failure on Mr B's part to explain why he has given some factors more weight than others.

Justice Perram noted that this complaint was closely allied to Mr B's failure to explain why he alighted on the six factors in the first place:

> *It is not known why those six factors in particular were selected and...Mr [B] does not explain why he thought that some were more important than others. This is a substantial criticism of Mr B's report and one which may ultimately impact on the value of the opinion. Strict compliance with what fell from [Makita] would lead to the conclusion that the report was thereby rendered inadmissible. However, for the reasons I have already given I am bound by the Full Court's decision in Red Bull not to approach [Makita] on that basis. Whist I have some misgivings about the value of the evidence in its current form I am constrained, at this stage, to admit it.*

Objection as to absence of qualifications

Counsel submitted that Mr B was not qualified to give evidence about insolvency. Justice Perram's reasons for rejecting this were:

> *Mr [B] is a qualified accountant and it is within the professional expertise of an accountant to express opinions on questions of solvency. I accept that he is not a member of any particular college or institute of insolvency practitioners and does not hold specialist qualifications in insolvency. However, that seems to me to be a matter going to the weight to be given to his evidence rather than to its admissibility.*

Objection as to absence of expertise relating to inferences

This objection concerned Mr B's second report in reply which was prepared in response to evidence filed by Danoz seeking to demonstrate its financial health. Mr B drew upon that material and proffered some comments upon it, including that "the available information indicates the Danoz Group ... had entered into special arrangements regarding payments to creditors". In the following paragraph he then explained that his reason for reaching that conclusion was correspondence attached to Danoz's statement, and that those matters provided some basis for drawing the conclusion of insolvency.

Counsel submitted that drawing the conclusion that the documents indicated that Danoz had entered into special payment arrangements with its creditors was a matter of fact for the Court and was not within Mr B's expertise. Relying on *Dean-Wilcocks v Commonwealth Bank of Australia*[5].

Justice Perram upheld this objection because the opinions expressed were "not wholly or substantially based on the specialised knowledge of the experts". The opinion offered "nothing more than the kind of analysis of the documentary facts that it is open to counsel to present in final submissions".

Significance

In dealing with the various objections raised in relation to the expert reports, Justice Perram provides important guidance on aspects of an expert's report which an expert will be concerned to ensure are appropriately addressed, in order to give that report the best possible chance of not only being found to be admissible, but also to be given appropriate weight. This includes:

- Ensuring in the selection process that the specific areas in issue are identified, such that the expert is able to assess whether his, or her expertise is adequate;
- Avoiding drawing inferences, unless these can demonstrably be supported by a clear process of reasoning based on the expert's specialised field of knowledge;
- Clearly setting out the reasons why particular factors have been considered, but not to the exclusion of any factors which the expert chose not to consider; and

- Clearly setting out the process of reasoning used to arrive at an opinion, in particular where the expert has given greater, or lesser, weight to certain facts or conclusions arrived at through analysis.

More relevantly however, this case provides guidance to experts and legal practitioners, not only in relation to the *Makita* principles themselves, but, more importantly the fact that it now appears well established that those principles are a *counsel of perfection*.

Whilst a Court may find admissible an expert's evidence, notwithstanding that "strictly speaking" it does not live up to *Makita* principles, an expert's report with such failings would appear to run the risk of being given little, if any, weight by the Court.

It would seem to be cold comfort for a client if the evidence is admitted but not given any weight, which highlights the need to select an expert with appropriate and specific expertise, who answers the appropriate questions in a carefully worded manner.

Further Reading

For further cases dealing with objections to expert evidence, the application of Makita principles and the counsel of perfection, see:

- Haissam Assafiri v The Shell Company of Australia [2010] NSWSC 930; where the affidavit of an expert architect was rejected on the basis that it failed to demonstrate a "logical chain of reasoning" or the "methodology employed to reach the conclusions expressed and as to the facts observed or assumed upon which the opinions are based".
- Willett v United Concrete Pty Limited and Anor [2009] NSWSC 957; a 'slip and fall' case involving the use of concurrent expert evidence, where the reports of experts were challenged on the basis of expertise and a failure to satisfy Makita principles (in particular to clearly express the assumptions upon which they were based).

Endnotes

1. *Makita (Australia) Pty Ltd v Sprowles [2001] NSWCA 305; (2001) 52 NSWLR 705*
2. *Sydneywide Distributors Pty Ltd v Red Bull Australia Pty Ltd [2002] FCAFC 157; (2002) 55 IPR 354*
3. *Adler v Australian Securities and Investments Commission (2003) 179 FLR*
4. *Paino v Paino [2008] NSWCA 276; (2008) 40 Fam LR 96*
5. *Dean-Willcocks (as liq of Austral Pacific Group Ltd (in liq)) v Commonwealth Bank of Australia (2003) 45 ACSR 564*

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