Eminent Forms Pty Ltd v Formosa & Anor – Death, taxes and costs

Neil Brown[1]

The only thing more certain than death and taxes is that the real fight in dispute resolution often ends up being about costs.

Indeed, a recent South Australian case suggests that if things do not improve, we will soon be re-living the nightmare of *Jarndyce v Jarndyce*. Aficionados of Dickens will recall that this was the equity case in *Bleak House* that had meandered on for so long through the courts in England that the brief was handed down from father to son and the case ground to a halt only when the costs had exhausted the entire value of the estate.

For a while, *Eminent Forms Pty Ltd v Formosa & Anor ('Eminent')*[2] seemed to be heading the same way. It has just had its latest, and hopefully its last, outing in the Supreme Court of South Australia. I say this because it was a dispute essentially over $30,000 which has now been to an arbitrator three times and to the highest court in the State another three times – and usually over the issue of costs.

The saving grace of the decision is that Mr Justice Gray, in the latest round in the Supreme Court, as well as observing euphemistically that it was a matter of 'some concern' that the proceedings had rambled on for so long, seems to have succeeded in clarifying the principles of costs in arbitration proceedings.

More particularly, the case clarifies the vexed question of how costs should be awarded where one party has won the war but lost the battle – where one party has won on the substantial issues that the case was really all about, but lost on a strict accounting balance or 'flow of funds'. Should that party expect to win its costs, or at least part of them?

The facts

The case originated with a domestic building contract under which the builder Applicant ('Eminent') was to make some alterations and additions to the Respondents' ('the Formosas') home.

Eminent claimed its first progress payment, which the Formosas declined to pay on the ground that Stage 1 of the works had not been completed. Eminent issued a notice of termination which the Formosas accepted as an unlawful repudiation of the contract. The Formosas served a notice of dispute and the dispute went to an arbitrator – for the first time.

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1 The Hon Neil Brown QC is a Barrister, Arbitrator and Mediator with a long experience in government and the law. He has had a long-term interest and involvement in all forms of ADR. He is a member of the Panel of Conciliators at the International Centre for Settlement of Investment Disputes (ICSID) in Washington DC, a member of the World Intellectual Property Organisation (WIPO) Arbitration and Mediation Panel and a member of the equivalent body at the National Arbitration Forum in the USA. He is a graded Arbitrator and accredited Mediator.

2 (2005) SASC 282.

First arbitration

The arbitrator awarded some damages to the Formosas and nothing to Eminent (i.e. none of its progress payment).

First trip to the Supreme Court

Eminent appealed to the Supreme Court, where a Judge allowed the appeal and the award was set aside.[3] The reality, the Judge said, was that the builder had substantially performed the work to be done in Stage 1, as the whole progress payment was $31,423.50 and the only part of the work omitted from Stage 1 was two coats of xypex on the cellar walls worth $2,340.00.

But, clearly, Eminent's termination was wrongful, and the Formosas were right in refusing to make the whole of the progress payment when the whole of the work had not been done. So the Formosas were entitled to damages for that breach and those damages came to $16,685.

However, the builder was entitled to most of its progress payment, $29,083. 50: the whole amount less the costs of the xypex, because it had committed no fundamental breach.

On the adjustment of these entitlements, the result was that the Formosas owed the builder the difference, $12,398.50.

Thus the Formosas won the war, for Eminent had wrongly terminated the contract, which was what the case had all been about. However, Eminent won the battle: it was $12,000 up on the flow of money between the parties.

The issue of costs then reared its head and the case was sent back to the arbitrator to assess them.

Second arbitration

The issue was very clear. One party had won the real issue in the case, which had occupied 90% of the hearing, but the other party had won most of the money. In those circumstances, the arbitrator said, he had to follow 'the current law' to determine who paid the costs. The current law was that costs go with the result of a 'balance judgment', which in this case was in favour of Eminent.

The Formosas, as the arbitrator predicted, felt this result was 'unfair', for they had won the case but lost the costs. It was therefore, in one sense, their turn to appeal to the Supreme Court, which they duly did.

Second trip to the Supreme Court

The general rule, a Judge decided, was that 'the party ultimately successful on the net balance awarded should recover costs.'[4] However, to every general rule, there are exceptions.

Where the arbitrator had gone wrong, it was held, was in not applying properly the rule of law that costs are discretionary. Moreover, the discretion was reinforced by the fact that it was embodied in legislation in s 34(1) of the *Commercial Arbitration Act* of South Australia. As there was discretion, the exceptions could not be limited, as the arbitrator had in effect done. If the discretion were restricted in

3 *Eminent Forms Pty Ltd v Formosa & Anor* (2004) SASC 192.

4 *Formosa & Anor v Eminent Forms Pty Ltd* (2005) 91 SASR 6 at [19].

this way, it was no longer really a matter of discretion, but a rule of law which was not what was intended by the legislation.

Of course, discretion must be exercised judiciously and not capriciously, but if the proper exercise of discretion, after weighing up all the circumstances, led the arbitrator to the conclusion that the Formosas had really 'succeeded in the litigation', then the costs should have gone in their favour, even although they recovered less money than Eminent on the 'net balance awarded' test.

It is of, course, sometimes difficult to determine who has actually 'won' a court case or an arbitration, especially a building case, where the case is likely to have been fought and decided on a whole series of separate issues; parties often win some and lose some.

So the first step is to look at what the case was really about. What were the real issues, the substance of the case? And how do you determine what was 'the substance' of a case?

A recent and useful guide on this issue has been given in New South Wales by McDougall J in *A&P Parkes Constructions Pty Ltd v Como Hotel Holdings ('Parkes Constructions')*.[5] In that case His Honour said that the test was whether there was:

> *a dominant issue that led to the plaintiff receiving substantially less than the amount of his claim. In my judgment, where that cannot be shown the proper approach…[was the approach adopted by Mr Justice Cole in* Mackinnon v Petersen *(19 April 1989 unreported), where Cole J] … indicated that in a building case, where ordinarily the quantification of the plaintiff's claim will involve the examination of a large number of individual items, it would be inappropriate to award the plaintiff less than the full amount of its costs simply because it had not achieved the full amount of the claim unless … there was a clearly dominant or severable issue that had in substance led to the reduction. As I have said, it does not appear there was any such issue in this case.*[6]

Accordingly, the Plaintiff in *Parkes Constructions* was awarded the entirety of its costs.

In other words, the question was, had the Plaintiff received less than their full claim because it had lost on a 'dominant or severable issue'? If it had lost on this 'dominant or severable issue', the proper exercise of the discretion would probably deny the Plaintiff its costs; but if it had won, the proper exercise of the discretion would probably result in an award of costs.

This notion of the 'dominant or severable issue' is consistent with the view expressed by the Judge in *Eminent*.[7] That is, to look for which party had 'succeeded' in the litigation, meaning, which party had succeeded overall, taking the substance of the proceedings as a whole.

The question was then: which party had really won the arbitration, Eminent, which had got an order for more money than the Formosas, or the Formosas, who had established that their builder had wrongly repudiated the contract?

The Judge did not decide that question, but sent the case back to the arbitrator to decide the issue of costs in accordance with the law just stated.

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5 (2004) NSWSC 792.

6 Ibid. at [11].

7 *Formosa v Eminent Forms*, above n 4.

Third arbitration

This time the arbitrator ordered Eminent to pay its own costs of the reference and the previous two awards, 90% of the Formosas' costs of the reference and 90% of their contribution to the costs of the awards. The basis on which the arbitrator did this was that, as Gray J put it, paraphrasing the arbitrator, the Formosas had really been:

> *successful on all substantial issues brought to arbitration and were entitled to the bulk of their costs, despite the fact that the balance payment, on appeal, was in favour of (Eminent).*[8]

One would have thought after that clear and definite statement that the matter could have been left there. But that was probably too much to hope for and Eminent appealed.

Third trip to the Supreme Court

On the application for leave to appeal, Eminent argued that the way the arbitrator had judged the matter, even after guidance from the Supreme Court, was unjudicial and capricious and that, as a consequence, there had been an error of law. The basis for this argument was a series of complaints about what the arbitrator had and had not taken into account in reaching his conclusion.

Gray J entered the lists with some very robust observations that put paid to those complaints, noting that nothing had been put on appeal to particularise them, at least not to the extent that they showed an unjudicial exercise of discretion.

The arbitrator had applied the proper test, His Honour said, in awarding the costs to the Formosas, for he had concluded that Eminent:

> *had been unsuccessful in regard to the vast majority of issues addressed in the arbitration and that the(Formosas) had been successful.*[9]

The 'vast majority' of the issues had revolved around whether Eminent had properly terminated the contract and the consistent finding had been that it had not.

Accordingly, as Eminent had failed on 'the vast majority' of the issues, it should pay 'the vast majority' of the costs , although on the balance sheet it was entitled to more than the Formosas.

It is submitted that this is the correct way to approach the question of costs, for to do otherwise would be to go contrary to the words of the discretion conferred by statute. Guides like 'costs follow the event' cannot be set in stone or turned into rules when an Act of Parliament provides that costs are discretionary; a discretion requires everything to be weighed in the scales, unencumbered by rules.

Indeed, this approach was probably established even before the present case was decided, although it is good to have it reinforced.

Thus, in *Panmal Constructions Pty Ltd (ACN 001 305 639) v Warringah Formwork Pty Ltd (ACN 002 797 417) ('Panmal Constructions')*,[10] it was said by Einstein J that:

> *Costs need not "follow the event"; rather, costs are in the discretion of the arbitrator.*[11]

In that case, it was argued and accepted by the court that an arbitrator had proceeded wrongly by

8 See above n 2 at [11].
9 Ibid. at [20].
10 (2004) NSWSC 204.
11 Ibid. at [15].

not taking into account an oral Calderbank offer to settle the arbitration before it had started. Instead, the arbitrator had made an arithmetical calculation (an erroneous one at that) to work out who was to be paid what and he then:

> *appears to have approached the whole costs question upon the basis that there is a "general rule that costs should follow the event".*[12]

That was an erroneous approach. Essentially the award of costs is a matter of discretion in all the circumstances, not a matter of laying down a 'rule'.

Drawing on further authority to that effect, Einstein J in *Panmal Constructions* said:

> *it is to be noted that in* Letterbox Holdings Pty Ltd v Kirkham *[2003] NSWSC 177 (Supreme Court of New South Wales, 21 March 2003, Nicholas J observed [at 57]:*
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> > *"S34(1) of the Act confers a broad discretion. It does not declare that costs automatically follow the event. The discretion must be exercised judicially in accordance with established principles and factors directly connected with the litigation."(see generally* Oshlack v Richmond River Council *(1998) 193 CLR 72 at 96–98).*
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> *…(in* Oshlack*) McHugh J, with whose reasons for judgment Brennan CJ was in general agreement, after dealing with the statutory discretion conferring on the Court a broad discretion as to award costs, said at 101:*
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> > *"The Discretion Must be Exercised Judicially."*
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> *Although the statutory discretion is broadly stated, it is not unqualified. It clearly cannot be exercised capriciously. Importantly, the discretion must be exercised judicially in accordance with established principle and factors directly connected with the litigation. In this manner, the law has gradually developed principles to guide the proper exercise of the discretion and, in some cases, to highlight extraneous consideration, which, if taken into account, will cause the exercise of the discretion to miscarry. Consistent with the aim of justice, the law could not have developed otherwise . . . by far the most important factor which Court has viewed as guiding the exercise of the costs discretion is the result of the litigation. A successful litigant is generally entitled to an award of costs.*[13]

Finally, Mr Justice Einstein observed in *Panmal Constructions*, that:

> *the arbitrator erred in apparently treating as a general rule, the proposition that costs require to follow the event, whereas this is no more than a general statement of an important parameter of the general discretion to award costs, there being any number of other considerations which may in a given case required to be weighed.*[14]

12 Ibid. at [50].

13 Ibid. at [47].

14 Ibid. at [54].

Finally, to return to *Eminent*, as the arbitrator had applied the correct test in determining the costs, Gray J was able to dismiss the application for leave to appeal against the arbitrator's award by observing that there was no 'manifest error of law on the face of the award or strong evidence that the arbitrator made an error of law'.[15]

It is to be hoped that these principles, stated, one would have thought, with commendable clarity will now be followed and applied in other decisions.

15 See above n 2 at [24].