

P.R.I.M.E. FINANCE 6TH ANNUAL CONFERENCE

PEACE PALACE, THE HAGUE

23 JANUARY 2017

EXPERT EVIDENCE IN AUSTRALIAN COURTS

The Hon Arthur R Emmett AO QC¹

Contents

Introduction	2
Admissibility of opinion evidence	5
Discretionary exclusions	7
The Expert Witness Code of Conduct	8
Receiving expert evidence	9
Concurrent Opinion Evidence	11
The Joint Conclave and Joint Report.....	12
Oral Evidence	13
Conclusion.....	17

¹ Acting Judge of Appeal, Supreme Court of NSW; formerly a justice of the Federal Court of Australia and Judge of Appeal of the Supreme Court of NSW. I acknowledge my indebtedness to papers delivered by Justice Peter Garling RFD (Supreme Court of NSW) to the Faculty of Law, Oxford University on 1 December 2015 (*Concurrent Expert Evidence – The New South Wales Experience*) and by Justice Robert McDougall (Supreme Court of NSW) to the Resolution Institute on 2 November 2016 (*The Utility of Expert Evidence in Dispute Resolution*).

Introduction

There are two purposes for expert evidence. First, an expert can furnish the court with scientific or technical information that is likely to be outside the experience and knowledge of a judge. Secondly, expert opinion evidence is admissible with respect to a relevant matter about which ordinary persons are not able to form a sound judgment without the assistance of those possessing special knowledge or experience in the area. A significant field for opinion evidence is valuation.

May I give, as an example, the case of *Bathurst Regional Council v Local Government Financial Services Pty Ltd* in the Federal Court of Australia ([2012] FCA 1200), about which I spoke at this conference several years ago. The case involved claims arising from the sale and purchase of a structured financial product known as a constant proportion debt obligation (**CPDO**), which were rated AAA. The CPDO was a complex, highly leveraged credit derivative, operating over a term of 10 years, within which the CPDO would make or lose money through notional credit default swap contracts (**CDS contracts**) referencing the CDX and iTraxx indices (together, weighted 50% each, known as the **Globoxx index**). It was described in the evidence as “grotesquely complicated”.

CPDOs enabled investors to invest in the performance of the CPDO as parties to notional CDS contracts, with the counterparty being the inventor of the instruments, ABN Amro Bank NV (**ABN Amro**). Under the notional CDS contracts, the investors were the notional sellers of protection against default by entities listed on the indices and ABN Amro was the notional buyer of the protection. The investors were long on the indices and ABN Amro was short. Apart from the guaranteed fees and charges to ABN Amro as arranger, the notional CDS contracts involved a form of zero sum game because the interests of the investors as protection seller and ABN Amro as protection buyer were necessarily opposed.

The capacity of the CPDO to earn money depended on a complex interaction between mark-to-market losses compared to higher premium income in scenarios where credit spreads on the indices increased. The performance of the CPDO thus depended upon how credit spreads evolved on the Globoxx index over the 10 year term of the CPDO. The CPDO was ultimately an extraordinarily complicated bet on the future performance of the Globoxx index over a period of up to 10 years.

In order to determine what rating the CPDO warranted, it was necessary to model its performance using a method capable of simulating numerous modelled outcomes. Monte Carlo modelling was commonly used for that purpose. Because the evolution of the various spread paths resulting from

Monte Carlo modelling would occur within the boundaries set by certain key inputs into the modelling, the determination of those inputs was crucial.

Expert evidence was given in the case that, in order to rate the CPDO, a reasonably competent ratings agency had to model the performance of the CPDO on the basis of ranges of inputs or market conditions that included both reasonably anticipated or expected inputs or market conditions and exceptional, but plausible, inputs or market conditions.

ABN Amro engaged Standard and Poor's (**S&P**) to rate the CPDO. ABN Amro pressed S&P to adopt its own model inputs as the basis for the rating. ABN Amro wrongly asserted to S&P that the actual average volatility of the Globoxx since inception was 15%. In fact the actual average volatility of the Globoxx since inception was 28% or 29%, nearly double that asserted by ABN Amro.

S&P believed ABN Amro's assertions that the actual average volatility of the Globoxx index since inception was 15% and did not calculate the volatility for itself although it could easily have done so. S&P thus modelled the CPDO thereafter for rating purposes on the basis of an incorrect assumption that the actual average volatility of the Globoxx index since inception was 15%. That assumption as to volatility was unreasonably and unjustifiably low. The court was satisfied that, but for that error about volatility, the CPDO could not have been rated AAA by S&P on any rational or reasonable basis. The also Court

found that S&P drew further arbitrary, irrational and unreasonable distinctions, the result of which was that, on S&P's approach, the CPDO achieved the AAA rating default rate.

Expert evidence was adduced to educate the court. Thus, evidence was given about how the relevant financial markets operate, and how a participant in the market normally goes about rating a financial instrument. That was essentially factual evidence. When such expert evidence is formulated with sufficient specificity, there will often be no dispute between experts about such matters.

Secondly, evidence was given as to what S&P must have done, to the extent that there was a dispute about such matters, and what it ought to have done. That involved the expression of opinions. In respect of such matters, a dispute will more often arise.

Admissibility of opinion evidence

The admissibility of evidence in Australia is governed by the provisions of the uniform Evidence Act, which is applicable in federal courts and several states, including NSW. Under the Evidence Act, the fundamental rule is that evidence, to be admissible, must be such that, if it were accepted, it could rationally affect (directly or indirectly) the assessment of the probability of the existence of a fact in issue in the proceeding. However, the Act excludes

opinion evidence, subject to a number of exceptions. Relevantly, the exclusion does not apply to an opinion of a person who has specialised knowledge based on the person's training, study or experience, provided that the opinion is shown to be wholly or substantially based on that specialised knowledge.

There are three key elements that must be satisfied in order for the exception to apply. First, the person whose opinion is to be given in evidence must have "specialised knowledge". Specialised knowledge must be knowledge rather than belief and it must be clearly identifiable as knowledge in a field in which specialised knowledge exists. The concept of "specialised knowledge" imports knowledge that is sufficiently organized or recognized to be accepted as a separate body of knowledge or experience of matters, being matters that are outside the knowledge or experience of ordinary persons. Thus, the witness must be shown to possess particular knowledge that derives from an area beyond the expertise of ordinary persons.

Secondly, that specialised knowledge must be based on training, study or experience. The expert's training, study or experience must be shown to have resulted in the acquisition of identifiable knowledge of the requisite kind.

Thirdly, the opinion must be wholly or substantially based on that knowledge. There must be a reasoned process by which it can be shown that the opinion proffered is wholly or substantially based on the expert's specialised knowledge. The expert is required to identify clearly his or her reasoning

process, and the particular facts or assumptions on which the opinion is based. Thus, a party seeking to adduce opinion evidence must prove that, to the extent that the opinion is based on facts:

(a) if the facts were “observed” by the expert, they have been identified and admissibly proved by the expert; and

(b) if the facts were “assumed” by the expert, they have been identified and proved in some other way.

If those criteria are not explicitly addressed then it will not be possible to demonstrate that the opinion is based wholly or substantially on the expert’s specialised knowledge and the evidence is not admissible.

Discretionary exclusions

If an expert’s opinion is otherwise admissible, the evidence may still be rejected, or its use limited, under discretions conferred by the Evidence Act. Thus, the court may refuse to admit evidence if its probative value is substantially outweighed by the danger that the evidence might be unfairly prejudicial to a party, be misleading or confusing, or cause or result in undue waste of time. In addition, the court may limit the use to be made of evidence if there is a danger that a particular use of the evidence might be unfairly prejudicial to a party, or be misleading or confusing. That provision can be used in a practical way to limit the use of the expert opinion evidence.

The Expert Witness Code of Conduct

An expert witness must comply with the code of conduct set out in a schedule to the Rules (**the Code of Conduct**), and as soon as practicable after an expert witness is engaged or appointed, the expert witness must be provided with a copy of the Code of Conduct. Unless the court otherwise orders, oral evidence may not be received from an expert witness unless the court is satisfied that the expert witness has acknowledged that he or she has read the code of conduct and agrees to be bound by it.

The Code of Conduct applies to any expert witness engaged or appointed to provide an expert's report for use as evidence in proceedings or proposed proceedings, or to give opinion evidence in proceedings or proposed proceedings. Under the Code of Conduct, an expert witness has an overriding duty to assist the court impartially on matters relevant to the expert witness's area of expertise. An expert witness's paramount duty is to the court and not to any party to the proceedings (including the person retaining the expert witness). An expert witness is not an advocate for a party.

Under the Code of Conduct, an expert witness, when complying with any direction of the court to confer with another expert witness or to prepare a parties' expert's report with another expert witness in relation to any issue, must exercise his or her independent, professional judgment in relation to that issue, must endeavour to reach agreement with the other expert witness on that issue,

and must not act on any instruction or request to withhold or avoid agreement with the other expert witness. If an expert witness who prepares a report believes that it may be incomplete or inaccurate without some qualification, the qualification must be stated in the report. If an expert witness considers that his or her opinion is not a concluded opinion because of insufficient research or insufficient data or for any other reason, that must be stated when the opinion is expressed.

Receiving expert evidence

The most common method of adducing expert evidence is through experts retained by the parties to assist in the technical matters of the case. It is not unusual for experts to assist parties during preparation of the case, and then to appear as an expert witness. A person who has been advising a party on matters within the person's expertise is not, in principle, disqualified from giving evidence as an expert witness.

The court has power to direct the parties to appoint a single expert for a particular issue. Where the court orders that an expert be engaged jointly by the parties affected, the single expert is to be selected by agreement between the parties and, if agreement cannot be reached, the court may appoint someone. The parties are to agree on written instructions to be provided to the expert concerning the issues arising for the expert's opinion and concerning the facts,

and assumptions of fact, on which the report is to be based. All parties affected are entitled to cross-examine the joint expert.

Further, the court may appoint its own expert to inquire into and produce a report on any particular issue arising in the proceedings. The court may choose the expert either based on recommendations from the parties or at its own discretion. Such an expert witness is not an assessor or a referee, but a conventional independent expert. The court may give the expert directions as to the issues that he or she is to deal with, and the facts and assumptions to be relied upon in forming the opinion. Without the leave of the court, the parties are not to adduce any further expert evidence in relation to the issue that the court-appointed expert is engaged to cover. However, all parties affected are entitled to cross-examine the expert. Of course, parties may retain their own experts to advise and assist.

In addition, the court may obtain assistance from any person specially qualified to advise on any matter arising in the proceedings, and may act on the adviser's opinion. The role of such a person is to assist the court to understand scientific and technical evidence. The advice given by the adviser is not given on oath, and is not subject to cross-examination by the parties. The court is not bound to follow the advice given. The primary role of such an adviser is to provide assistance to the court in interpreting or facilitating the court's understanding of the scientific and technical evidence and issues before it. As a

matter of procedural fairness, where such advice is provided to the court, its substance must be disclosed to the parties so that they can deal with it.

Concurrent Opinion Evidence

The giving of concurrent expert evidence has been regularly adopted in Australian Courts. All of the experts are required to attend and give their evidence to the court together, hence the term concurrent evidence. It has become politically incorrect to use the original vernacular “hot-tubbing”.

Concurrent evidence has been described as being essentially a discussion chaired by the judge, in which the various experts, the parties, advocates and the judge engage in an endeavour to identify the issues and arrive where possible at a common resolution of them. A structured discussion, with the judge as chairperson, allows the experts to give and defend their respective opinions without constraint by the advocates, in a way that enables them to respond directly to each other. The judge has the benefit of multiple advisors, who are rigorously examined in a public forum.

In the course of case management, the Court will normally require each of the parties to produce a statement of the findings of fact for which that party contends, prepared in the form of assumptions that the experts will be asked to make for the purposes of expressing an opinion, together with a list of issues

that the party contends arise from the expert reports. The list of issues is important because it largely becomes the agenda for a joint conclave of the experts, an outline for a joint report by the experts and, subsequently, the agenda for the concurrent evidence session.

The Joint Conclave and Joint Report

The joint conclave is attended by the retained experts and takes place in the absence of the lawyers for the parties. The experts are required to discuss the issues set out in the statement of issues settled by the judge and to attempt to reach agreement, where possible, on some or all of those issues. The discussions held during the joint conclave are confidential to the participants, and cannot be traversed in oral evidence. The experts are therefore free to discuss matters, articulate their views to their colleagues and change their minds and modify their views without any fear of the process being used in evidence to form the basis of a challenge to their ultimate position.

In some circumstances, it may be desirable to appoint an individual to chair or facilitate the conclave to ensure that the views of each participant are expressed, that an adequate discussion takes place with respect to each of the identified issues and that the views of each expert are accurately and succinctly recorded. The chairperson might be from the same profession as those involved

in the joint conclave, a senior barrister, or a retired judge. A chairperson is particularly useful where the participants in the joint conclave are not all present in the room together, but some are participating by other means. The chairperson can then ensure that the views of the participants who are not present are taken, shared and discussed, thereby giving each expert an adequate opportunity to participate.

The joint report must specify matters agreed and matters not agreed and the reasons for any disagreement. The joint report may be tendered at the trial as evidence of any matters agreed. In relation to any matters not agreed, the joint report may be used or tendered at the trial only in accordance with the ordinary rules of evidence and the practices of the court. Except by leave of the court, a party may not adduce evidence from any other expert witness on the issues dealt with in the joint report. The joint report is to disclose clearly the matters agreed upon and not agreed upon, the nature and extent of the disagreement, and the reasons for that disagreement.

Oral Evidence

The course of the concurrent evidence generally follows the list of issues that has been provided to the experts, which has formed the basis of the joint report. Commonly, the trial judge will commence by establishing what the state of agreement is with respect to each issue separately, and will then elicit the

other opinions and the basis for them, on that issue. The trial judge may seek an explanation as to why an opinion is held, and why the differences of opinion exist. As that questioning develops, the trial judge will call on any opposing expert to explain his or her view and the basis for it, and then ask each expert to identify what the real difference is and how that is justified from the perspective of each of them. That process often sparks questions from one witness to the other or others, and comments by one witness on what the other witness has said. The aim is to establish a real and professional dialogue on the issues that are disputed, to ensure that the judge is adequately informed of the experts' opinions in their own words.

The giving of concurrent evidence is intended to constitute a co-operative endeavour is to identify the relevant issues and, where possible, arrive at an agreed resolution of them. To the extent appropriate, the concurrent evidence is subject to judicial control, much like the control by a chair of a meeting. However, concurrent evidence differs from a meeting because it is critical that all appropriate formality is observed, as the context for the "professional discussion" remains the giving of sworn evidence in a courtroom.

Accordingly, at the conclusion of the first issue (or item on the agenda) and after the judge has finished raising any matters, counsel for each of the parties then, in turn, can question the witnesses ensuring as they do that each expert has the opportunity to answer the question asked. The purpose of

counsel's questions is to ensure that an expert's opinion is fully articulated and tested against a contrary opinion, perhaps even an opinion elicited by the judge. Thus, the examination of the experts by counsel bears little similarity to the typical cross-examination. When concurrent evidence is being taken by the judge, counsel can and should seek to raise material issues and put material questions to the witnesses, if necessary submitting that the judge's view of how the evidence should be brought out should be modified.

The process is repeated for each item on the list of. Provided that everyone understands the process at the outset, there is usually no difficulty in managing the hearing justly and efficiently. At the end of the concurrent evidence session, the judge will usually endeavour to ensure that all of the experts have had the opportunity to explain their positions fully, and adding anything relevant that may have been overlooked.

In considering the timing of the concurrent evidence session, one question is whether the court ought to require that all of the relevant witnesses of fact who are to be called by any of the parties give their evidence before the concurrent evidence session. Niceties may arise about whether the evidence is being given in the case of one party or another. That could have some effect upon the making of a forensic decision whether or not to call evidence.

The importance is greater in circumstances where the experts have been asked to make various factual assumptions upon which to base their joint report

(or their earlier individual reports). The acceptance or rejection of expert evidence, or the weight to be given to it, necessarily depends upon the extent of the coincidence between the assumptions of fact made by the expert witnesses, and the facts that are proved in the evidence.

The practice generally followed is for the concurrent expert evidence session to be scheduled to take place at the end of the hearing. That means that all of the factual evidence to be called must be called before the experts give their evidence. That enables the parties to formulate any additional assumptions of fact to be put to the experts, and enables the experts to give their opinions on much more complete sets of factual assumptions than might otherwise be the case. It ensures so far as possible that there will be coincidence between the proved and assumed facts.

In cases where the facts are likely to be particularly complex and are only likely to be revealed after many witnesses have given evidence and been subject to cross examination, the Court may order that the trial be conducted in phases, where the initial phase is devoted to the factual evidence and then, after parties have had the opportunity to consider the factual evidence and prepare statements of factual assumptions, the process of concurrent evidence can begin. There may be a break between the phases, which has disadvantages.

Conclusion

The process impacts on the ability of counsel to control the development of the evidence and the ability to control an expert as a witness in cross examination. Thus, in the usual adversarial process, counsel chooses and carefully formulates the question that he or she wishes to ask, and then insists that the expert witness answer that question to elicit a particular answer. Counsel can follow particular threads through to a particular conclusion or may decide to stop at a point seen as being an advantageous position. Thus, the traditional adversarial process gives counsel a greater degree of control and influence on the content of the expert's evidence. On the other hand, the process concentrates the cross-examination of experts and can reduce the time spent on cross-examination.

From the perspective of the Court, the process can narrow the issues that are in dispute between the parties to a significant extent, thereby making more efficient the decision making process, and shortening the process of judgment writing. When considering the evidence for the purpose of writing a judgment, opinions on similar issues are easily identifiable by the judges, since each expert gives an answer to the same question. The transcript contains the whole of the expert debate in a limited number of pages. Because of the opportunity to observe the experts in conversation with each other about specific matters, the

capacity of the judge to decide which expert to accept is greatly enhanced. Rather than have a person's expertise translated or coloured by the skill of the advocate, the judge has the expert's views expressed in his or her own words.

There are different views as to whether there are advantages in concurrent expert evidence, and the extent of any such advantages. The advantages may depend upon the particular litigation in which the process is invoked. The absence of any rigorous analytical studies may preclude the formation of any sound conclusions.