Alliancing and Partnering — The Failure of the Relationship

Thiess Contractors Pty Ltd v Placer (Granny Smith) Pty Ltd
Full Court of the Supreme Court of Western Australia
Unreported, 14 April 2000

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ALLIANCING AND PARTNERING IS about building long-term relationships between participants in a project. The benefits of a successful alliance can be significant for both principals and contractors. Those potential benefits do not come without a price. The downside of the alliance method of project delivery is that there is often a high degree of uncertainty as to precisely what the parties' obligations are under the alliance agreement.

The alliance concept is wrapped up with notions of good faith and fair dealing, as well as hints of a fiduciary character in some respects. Alliancing, like its partnering predecessor, is 'relationship driven'. It is incumbent upon the parties to act in good faith toward each other, as well as to act in the best interests of the project. The reason that there are few examples of this method of project delivery failing is the use of 'commercial drivers' and painshare/ gainshare clauses. The uncertainty of the 'no dispute clause' also operates as a disincentive to parties allowing the project to fail.

This article will examine the decision of the Full Court of the Supreme Court of Western Australia in *Thiess Contractors Pty Ltd v Placer (Granny Smith) Pty Ltd* (unreported 14 April 2000) (hereafter the '*Thiess* case'). The case is particularly important because it sheds some light on what may happen if an alliance contract fails. The project in this case was governed by a partnering agreement, although the same obligations of good faith are included in the partnering charters as in alliance agreements (albeit in a differing form).

TERMINATION

In most alliance agreements there is a clause(s) which governs the dispute resolution process. The clause usually provides for a process whereby personnel at different levels of the project attempt to resolve the issues in dispute between them. The final decision is usually left to the Project Alliance Committee ('PAC') and, in circumstances where they are unable to resolve the dispute, there is a termination clause which usually limits damages (both liquidated and non-liquidated) as well as prohibiting litigation.

The partnering approach is somewhat different, in that the documentation usually involves both a partnering charter and separate development contracts (i.e. AS2124) underlying the charter. Nonetheless, both approaches expressly or impliedly impose obligations to act in good faith on the parties to the agreement.

In the *Thiess* case both Thiess and Placer were parties to a partnering contract in respect of contract mining. In pre-contractual discussions and written communications, Placer proposed that the new contract be based on risk-sharing principles and that the parties 'work in good faith on all matters relating to the contract', and that the contract provide for a fixed profit to be earned by Thiess.

Placer terminated the contract in reliance on a termination clause contained in the contract which entitled it, at its option and at any time for any reason it might deem advisable, to cancel and terminate the contract. Thiess alleged Placer's termination was unlawful. Placer counter-claimed that in breach of the obligation of good faith, expressly provided for in the contract, Thiess had falsely represented that certain plant costs were its genuine estimates of the costs it would incur in carrying out work under the contract.

Thiess alleged that, prior to entering into the new contract, Placer represented that it would only rely on the termination clause to terminate the contract if the mine were closed or if the mine was uneconomic to work. Thiess contended that it altered its position in reliance on those representations and that Placer should be estopped from re-

lying on the termination clause. Thiess alleged two representations were made:

(a) A representation to the effect that the contract was for the life of the mine; and

(b) A representation to the effect that Placer could not see any situation in which it would invoke the termination clause.

FINDINGS

The Full Court held that Placer's exercise of its rights under the termination clause was not inconsistent with its representation that the contract was to be for the life of the mine. There were several provisions in the contract itself which indicated that the parties intended that mining be carried on by Thiess for the life of the mine. That intention was always subject to the termination clause. Furthermore, at the time that the representation was made, Thiess requested that Placer remove the clause and Placer refused. Placer would not have agreed to the contract without the termination clause. Plainly it was prepared to enter into the contract, which was to be for the life of the mine, but subject to its right to terminate under the clause should it wish to do so. Thiess had agreed to these terms.

In respect of the representations made by Placer during negotiations that it 'could not conceive of a situation in which it would exercise its rights under the termination clause,' this did not mean that it represented that, should such a situation arise, it waived its rights in respect of the clause. Thiess was aware of the risks of agreeing to the contract with the termination clause in it. At no time did Placer represent that it would not rely upon the termination clause that it had insisted be included in the contract.

The lessons from this aspect of the case are clear. Should contractual documentation contain termination clauses, even in circumstances where the contracts also provide obligations of good faith in respect of their interpretation, the document itself is still supreme. Certainly, in circumstances where there are oral representations that the clause will not be relied upon, it will be necessary for the clause to be removed in order to give effect to these representations.

GOOD FAITH

Alliance contracts invariably impose an obligation to act in good faith upon the parties. Partnering, arguably, also does this. Alliance contracts also generally require that the parties disclose their 'real costs' in keeping with the 'open book' approach. An obligation to act in good faith and to disclose true costs was present in the *Thiess* Case. For this reason, the decision is educative on the way in which these clauses may be interpreted in both a partnering and an alliancing context.

In the *Thiess* case Placer argued that:

I. by an express term of the contract Thiess owed Placer an obligation to act in good faith in the process of deriving the rates according to which remuneration under the contract was to be paid;

II. Thiess represented to Placer that certain plant costs incurred in carrying out mining operations were its genuine estimates of those costs;

III. those representations were deliberately false in that the plant costs, to Thiess' knowledge, contained elements of profit;

IV. Thiess thereby committed breaches of its contractual duty of good faith; and

V. as a result, Placer suffered damage.

THE DUTY TO PROVIDE GENUINE ESTIMATES OF COSTS

The contract covered a multitude of items in respect of which costs were to be incurred and rates charged. It also specified the profit to be made and how that profit was to be calculated. There were careful and detailed provisions made for the review of the rates.

Clause B 1.1.5 provided:

The successful operation of this contract requires that Thiess and Placer agree to act in good faith in all matters relating to both carrying out of the works, derivation of rates and interpretation of this document.

The contract provided for the agreement of rates, from time to time, in advance of work done. To that extent, it contemplated that agreed rates would be based on estimates of the costs of the work to be done. Implicitly, the parties were required to co-operate in the establishment of rates

based as far as was reasonably possible on actual costs. This was consistent with the scheme of the contract as a whole. The scheme of the contract as a whole and the obligation of good faith contained in clause B 1.1.5 required Thiess at each review to disclose all facts relevant to the establishment of rates based on actual costs. The contract required Thiess to provide Placer with a genuine estimate of its costs for the purpose of agreeing the rates in accordance with the contractual terms. In the course of agreeing upon variations as to rates, Thiess knowingly misrepresented to Placer that certain costs were its genuine estimate of costs (whereas those costs included elements of profit). Misrepresentations like this (made after the contract had been entered into) constituted a breach of clause B1.1.5.

MISREPRESENTATIONS

The representations in question were contained in a document referred to as the 'April submission'. Thiess represented to Placer that the rates in the April submission were it's genuine estimate of costs. The court found:

I. Thiess accepted the principles embodied in a letter from Placer to Thiess which provided that:

A. Placer recognises the right of Thiess to make a profit;

B. The nature of the contract removed the ability of Thiess to make 'windfall' profits; and

C. Placer and Thiess agree to work in good faith on all matters relating to the contract.

II. Placer's subsequent letter was an invitation to Thiess to produce the April submission using genuine estimates of its mining costs. In that letter, Placer referred to Thiess using the 'new contract concepts'. The 'new contract concepts' were the concepts set out in Placer's original letter to Thiess.

III. When Thiess produced its April submission the parties were negotiating on the basis that Thiess would provide genuine cost estimates. In seeking to agree to rates pursuant to the various provisions of the contract, the parties were obliged to act in good faith in estimating the future costs. As the whole aim of the contract was to establish rates that would be an estimate of the anticipated actual costs of the mining operations, and would not give rise to 'windfall' profits, the inference to be drawn is that the open book analysis was designed to enable this to be done. The parties would be expected to 'work in good faith' to agree on the costs on the basis of what would be genuine estimates of those costs.

IV. Thiess represented to Placer that the plant rates contained in the April submission were genuine estimates of costs.

BREACHES OF CONTRACT

There were two breaches of contract concerning representations made by Thiess when it provided rates to Placer (based in substance on the April submissions). Both breaches arose out of Thiess failing to act in good faith, as required by the contract, by knowingly misrepresenting that its rates were genuine estimates of its costs.

CAUSATION

The parties were required to exercise good faith in attempting to come to an agreement within the constraints implicitly provided for by the contract. Those constraints were imposed by the parties intent, as reflected by the contract, to provide a mechanism for the agreement of rates and amounts (based on the equivalent of the actual costs incurred by Thiess), prior to each relevant rates review. By the contract, the parties were obliged to attempt in good faith to agree to the rates (by reference to the genuine estimates of costs that each produced), with the intent that the agreed rates be estimated actual costs to be incurred by Thiess.

In consequence of Thiess' breaches of contract, Placer paid Thiess remuneration based on rates higher than those that would otherwise have been agreed. Placer was therefore entitled to damages for breach of contract represented by the difference between the remuneration paid by it to Thiess and the remuneration it would have paid had Thiess not breached the contract.

DAMAGES

The court held that damages could only be proved in the following manner:

I. identify each item of plant in respect of which an inflated rate was used;

II. in respect of each sub-item of plant, identify the Plant Department rate applicable thereto;

III. carry out an FPC simulation in accordance with the contract, using the appropriate Plant Department rates for load and haul so as to establish the notional contractual rates applicable thereto;

IV. calculate the notional contractual rates for the other items of plant referred to in paragraph (I), applying the appropriate Plant Department rates in accordance with the criteria laid down by the contract itself;

V. using the notional contractual rates so established, determine the revenue that *would* have been earned from the items of plant to which those rates applied;

VI. determine the revenue *in fact* earned from the plant to which the inflated rates were applicable; and

VII. deduct the revenue determined in accordance with paragraph (V) from the revenue determined in accordance with paragraph (VI).

This formula, which calculated the revenue that Thiess would have earned from the Plant (in respect of which inflated rates would not be used), when deducted from the revenue that Thiess in fact earned from the plant to which the inflated rate applied, would be Placer's damages. But Placer made no attempt to prove its damages in this way.

There were no grounds giving rise to the ordering of a retrial of the damages issue. The consequence was that Placer was entitled to nominal damages of $100.

LESSONS

This case demonstrates the importance of careful planning and contract administration when using new models of project delivery such as Partnering/Alliancing. Importantly, it shows that the nature of the obligation of good faith (regularly agreed by parties to construction and mining contracts) is a shifting one. Good faith obligations require the parties to be candid in their dealings with one another and require a less adversarial approach to be taken when considering the parties' rights and obligations under the contract. It also introduces great uncertainties in circumstances where the relationship breaks down. ■

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