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THE  
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ARBITRATORS & MEDIATORS  
—  —  
AUSTRALIA



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Volume 20 Number 2 July 2001

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# Contents

President's message.....	i
<i>Robert Hunt</i>	
Editor's commentary .....	vi
<i>Grant Holley</i>	
Letter to the editor.....	ix
<i>F McCardell</i>	

## Articles

Evidence for arbitrators .....	1
<i>David Byrne</i>	
Alliance contracting — why choose alliancing?.....	11
<i>JK Bremen</i>	
Andrews v Bradshaw — a different view.....	27
<i>AA de Fina</i>	
The Institute of Arbitrators & Mediators Australia rules for the conduct of commercial arbitrations .....	33
<i>Robert Hunt</i>	
Pitfalls of mediation .....	41
<i>George H Golvan</i>	
Current and future trends for dispute resolution on significant dams and related projects in Australasia .....	51
<i>Norman Reich</i>	

## Casenotes

Bengalla Mining Co Pty Ltd v Barclay Mowlem Construction Ltd .....	69
<i>Paul Venus</i>	
Multiplex Constructions Pty Ltd v Suscindy Management Pty Ltd .....	71
<i>David Talintyre</i>	

# Contents

## **Casenotes**

Abigroup Contractors Pty Ltd v BPB Pty Ltd.....	73
<i>David Talintyre</i>	
State of Victoria v	
Seal Rocks Victoria (Australia) Pty Ltd .....	76
<i>Robert Hunt</i>	
Walter Construction Group Ltd v	
Walker Corporation Ltd .....	78
<i>David Talintyre</i>	

# Alliance contracting — why choose alliancing?

*J K Bremen\**

## **When is alliancing appropriate?**

Construction and mining projects in Australia have a reputation for being 'dispute ridden'. Over the past few years there has been an industry backlash and calls for alternative approaches to both project delivery and dispute resolution.

The traditional contractual approach has been an adversarial one. As a result, a culture of variations and claims, price blowouts and litigation has come to characterise the building, construction and mining industries in Australia. This has had a significant impact upon the performance of industry in terms of productivity and efficiency. Industry concerns have led to demands over the past decade for alternative approaches in project delivery and dispute resolution which encourage the prevention and resolution of disputes.

As a response to the concerns of the industry a variety of 'co-operative' delivery structures (such as partnering) were developed to encourage parties to co-operate and to complete project work on time and within budget — with mixed results. While these 'co-operative' structures employ different approaches to the allocations of cost, time and risks compared to traditional lump sum contracting arrangements, they have been unable to consistently deliver a co-operative environment which successfully facilitates the prevention and resolution of disputes.

The project alliance is a method of delivery which (for the 'right' project) promotes a non-adversarial, mutually profitable environment for project participants. Alliancing offers a new paradigm for the principal/contractor relationship. The underlying rationale for alliance contracting is to use the contract itself (via 'commercial drivers') to motivate the principal and contractor to work together to achieve a mutually beneficial goal.

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\* BA, BCom, LLB(Hons); J K Bremen is a lawyer practicing with the Brisbane law firm McCullough Robertson. This paper was presented at the Earthmover and Civil Contractor Conference 11-12 December 2000, Sydney.

## THE ARBITRATOR & MEDIATOR JULY 2001

Alliancing represents an alignment of the financial interests of the principal and the contractor, thereby providing a financial incentive for parties to co-operate. Abrahams and Cullen describe alliancing as:

A project alliance may be defined as an agreement between two or more entities which undertake work co-operatively, on the basis of sharing project risk and reward, for the purpose of achieving agreed outcomes based on principles of good faith and trust and an open-book approach towards costs.<sup>1</sup>

Typically the parties to an alliance agreement will function as an alliance team: as separate entities to the organisation of the individual contracting participants. Despite sometimes being known as a 'virtual corporation', an alliance team is not to be regarded as a separate legal entity such as a company, partnership or joint venture. The advantage of this is that an alliance is relatively easy to dissolve at the conclusion of the project, or upon termination during the project itself. Project participants should be wary and ascertain whether any alliance agreement, particularly any charter, results in unintended legal obligations (that is, fiduciary obligations) being imposed upon the parties.

Before I descend into the detail of alliance agreements themselves, it is appropriate to spend a minute or two looking at when a project alliance is the most effective method of delivery for any given project.

The alliance model is one that lends itself to major projects that will (for example) benefit from flexibility in the way in which the works are executed and also in projects where scope is uncertain. The model is generally best used in larger, complex projects rather than one-off design and construction jobs. Furthermore, the alliance model is an appropriate model to use in circumstances where the relationships between the parties to the alliance (principal, contractor, subcontractor and so on) are ongoing ones and where it is likely that the parties will be doing business with each other on future projects. Thus, while a project alliance is directly relevant to one particular project, it is often part of broader strategy between companies seeking to informally align with one another and, accordingly, to build a relationship.

Thus the alliance model is not one that lends itself to quick 'profit taking' by any of the parties and instead adopts a long term view.

Other speakers in this seminar will address the history of alliancing. What I

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<sup>1</sup> 'Project alliance in the construction industry' (1998) 62 *Australian Construction Law Newsletter* at 31.

will do at this stage is provide some examples of when alliancing has been used in Australia and make a comment on its effectiveness.

While it is arguable that alliancing can be used in smaller projects, the projects that we have seen are largely those to do with major projects or infrastructure. We have also seen the alliance model widely used in the mining industry. Alliancing in these circumstances has proven remarkably successful.

### **Selecting alliance participants**

There has been a great deal written about the importance of selecting the appropriate alliance participants. In 1998 I was visiting Canada and had the opportunity to talk with Bonita Thompson QC, a leading advocate of alliancing and co-operative project delivery in Canada and the United States. She had just written a short paper, entitled 'Five steps to assessing partnering readiness', which argued that the success of any 'co-operative project delivery structure' (be it partnering or alliancing) was determined at the very outset by the selection process. The importance of selecting the right participants to an alliance cannot be overstated. It is imperative that the parties to the alliance are aware of the goals of the alliance and are committed to them. What I thought I would do here is not outline the characteristics that are necessary for the participants, as that has been done in countless articles, but rather outline the process whereby the participants may in fact be selected.

It is often the case that prospective alliance participants need to commit considerable resources to bid for the project. Accordingly, alliancing is generally best suited to major projects where the parties have the interest and the resources to commit to such a selection process. Nonetheless, getting the selection process right is crucial to the success of the alliance.

Ordinarily all participants in the selection process will receive some payment from the principal for taking part (workshops, interviews, and so on). This will usually be done on a 'cost' basis with no allocation for profit or overheads in respect of participation in the process. However, it is not unusual for the successful alliance participants, at a later date, to be able to recover a margin of profit for their participation in the selection process (dependent upon the overall performance of the project).

The alliance agreement will ordinarily consist of the agreement itself (which takes the form of a contractual document) along with a number of annexures containing things such as scope and so on. One of the annexures is usually an 'alliance charter' (although it may be a separate document). The alliance charter

## THE ARBITRATOR & MEDIATOR JULY 2001

### Alliance partnership projects

Year	Project alliance/ owner	Non-owner participants	Outcome *
94-96	Wandoo B Oil Platform WA Ampolex	Leighton Contractors Dawson Brown & Root Joint Venture Ove Arup Pty Ltd Keppel Corporation	Highly successful alliance — \$13 m under budget.
94-97	East Spar Project WA (oil and gas) WMC Resources Limited	Kvaerner Oil & Gas Clough Engineering	Outstanding outcomes. — winner of industry awards.
96-99	Hot Briquetted Iron (HBI) WA (iron ore) BHP	Various	[Information unavailable]
97-2000	Northside Storage Tunnel Project NSW (water management) Sydney Water	Transfield Tunnelling Connell Wagner Montgomery Watson Kilpatrick Green	Achieved significant cost savings and efficiencies.
98	National Museum Acton Point ACT - Building Commonwealth Government	Ashton Raggatt McDougall Robert Peck Von Hartel Trethowan Civil & Civic Tyco International Honeywell Limited Anway & Company	[Information unavailable]
2000	Inner Northern Busway - Section 1 Qld (urban development) Queensland Department of Transport	Transfield Construction Queensland Henry Walker Eltin Contracting GHD Pty Ltd Halcrow Pacific Pty Ltd	This alliance was terminated due to political difficulties between local and State governments.
2000	Pacific Motorway Package #3 Qld (road infrastructure) Queensland Department of Main Roads	Thiess Contractors SMEC Australia	Reached practical completion five months earlier than original forecast.
2000-2002	Gladstone Area Water Board Awoonga Dam Raising Project	Sun Water PPK Consultants Thiess Contractors	[Information unavailable]

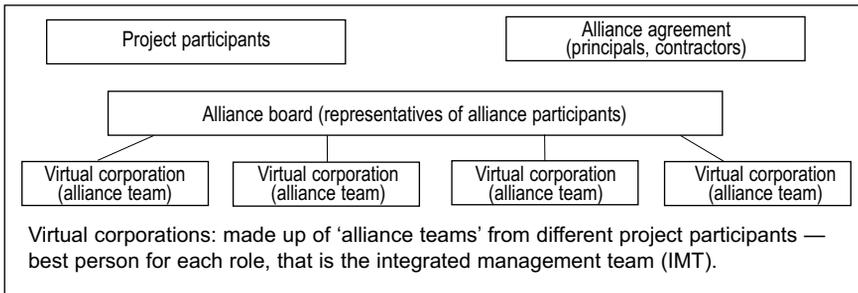
*\*Source: Ross J, seminar presented to the Institute of Engineers, 17 August 2000.*

is a broad statement by the participants as to the way in which they wish the project to proceed. While the charter appears, on its face, to be a broad 'motherhood' statement, it can (and in my view will) serve to inform the way in which the contract is interpreted in the event that a dispute arises. Furthermore the alliance charter has the potential to impose other duties upon the participants (such as potential fiduciary duties).

### Structure of the alliance

While I won't examine the structure of the alliance itself in great detail — instead, I shall examine the documentation of the deal on a practical level — I thought it appropriate to broadly outline the way in which an alliance might look.

Typical Alliance Structure



### The anatomy of an alliance agreement

What I thought I'd do here is give you a basic overview of the way in which an alliance agreement is likely to be put together. Each alliance is slightly different but there are certain key parts of the alliance agreements which will be inherently the same. Rather than provide an overview I thought it may be more useful to describe clauses from actual alliance agreements and to comment on them so that you can get a 'flavour' of what an alliance is all about.\*

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\* Editor's note: this version of Mr Bremen's article has been edited, for the sake of brevity, to refer only to those clauses that characterise an alliance agreement and those that are most relevant to conflict management and dispute resolution. For a full copy of the article please contact the Editor.

### ***Overriding commitments***

#### *Commitment to alliance principles*

The alliance participants hereby commit to work together in a manner so as to achieve the successful delivery of the alliance works.

This clause seems to us to say little, although it may have quite a substantial impact upon the way in which the courts interpret the agreement generally. What we mean by this is that it goes to suggest that there is a duty on the parties to act in good faith in respect of the contract. This will affect the way the contract is interpreted and the participants' obligations in respect of the contract itself. Nonetheless, it is in keeping with the general principles of alliancing and accordingly cannot be dispensed with unless there is a shift to a more traditional delivery model.

The alliance participants have developed, committed to and signed off the Alliance Charter in Schedule X. The alliance participants undertake to adhere to the principles set out in the Alliance Charter ('the alliance principles').

The alliance charter is likely to be viewed by a court as either a part of the alliance contract itself or as a collateral contract that goes to inform the interpretation of the alliance contract. The impact that the alliance charter has upon the participants' obligations under contract will be significant. Accordingly, the sorts of obligations that go under alliance charter will be crucial to the way in which the contract is to be interpreted and accordingly must be approached with the requisite caution.

#### *Commitment to act in good faith*

Each alliance participant undertakes to conduct its activities arising out of this PAA in good faith. Acting in good faith in this case includes:

- (a) being fair, reasonable and honest;
- (b) doing all things reasonably expected of it by another alliance participant and by this PAA;
- (c) not impeding or restricting another alliance participant's performance; and
- (d) giving as much weight to the interests of the project as to one's own self-interest.

There is a great deal in this clause but we note that there could still be more,

as the definition is 'inclusive'. In particular it colours the obligations of the contractor in respect of the things that it promises to do under the contract. Any disclosures that it makes needs to be honest and any exercise of rights under the contract needs to be seen as fair and reasonable. Furthermore, there is an obligation for the parties to do all things reasonably expected of them by another alliance participant (although quite what this means we are unsure). Perhaps this subclause could be clarified. In respect of the obligation not to impede or restrict another alliance participant's performance, we are of the view that this could also adversely affect the contractor's rights under the contract. The most concerning section is (d): 'giving as much weight to the interests of the project as to one's own self-interest'.

This clause indicates that the contractor may be unable to act in its own self-interest in respect of its exercise of a right under the contract. This obligation is a significant one. We do not think that this obligation necessarily imposes a fiduciary obligation on the contractor, although it comes close (a fiduciary duty is a duty to act in the interest on another party over one's own). What it does do is significantly limit the options that the contractor will have in respect of exercising its rights regarding things like termination.

### ***Project alliance board***

#### *Establishment duties and authority*

The PAB is hereby established with an overall charter to administer this PAA and provide guidance to the alliance participants with respect to the work under the alliance.

This clause provides for the establishment of the project alliance board (PAB).

The alliance participants must implement all decisions and directions of the PAB (and of the owner where expressly provided for in this PAA) in respect of the work under the alliance given in accordance with this PAA.

This clause provides for the obligation upon the contractor to comply with all directions of the PAB (the contractor will be represented on this board). Furthermore, the contractor must comply with all of the directions of the owner (where the owner has a right to direct under this contract).

## THE ARBITRATOR & MEDIATOR JULY 2001

### *Representation*

The PAB will consist of one or more senior representatives from each of the alliance participants (the PAB Members).

This clause provides for the membership of the PAB. The contractor would wish to ensure equal representation on the PAB with other alliance participants — in particular, the principal — and perhaps a weighting over the designers. We consider this important despite the requirement for unanimity for the PAB's decisions (see clause below).

At the time of the execution of this PAA and unless and until advised otherwise by an alliance participant the PAB Members are those persons nominated in the Annexure.

It is imperative that the contractor select the appropriate personnel for membership of the PAB. As will become evident later in the contract, PAB decisions need to be unanimous. Accordingly, an appropriate person or persons with the appropriate interpersonal skills needs to be nominated for this role.

Subject to clause X.X.X, an alliance participant may replace its PAB Member(s) at any time, or nominate a substitute (substitute PAB Member) by giving notice in writing to the other alliance participants at least 24 hours prior to the change in representation.

This clause provides that the members of the alliance board may be changed with 24 hours notice.

The alliance project manager or acting alliance project manager may not act as a substitute PAB Member.

This clause simply provides that the alliance project manager may not sit on the PAB.

In respect of any matter which is within the powers of the PAB as contemplated by this PAA, the individual PAB Members (and their substitute PAB Members) are hereby authorised to bind the alliance participant they represent to the decisions of the PAB.

## THE ARBITRATOR & MEDIATOR JULY 2001

This clause provides that the contractor's representative(s) on the PAB can enter into binding agreements with the PAB in respect of the contract. What this means is that the contractor will be contractually bound by its representative on the PAB. Accordingly, it would be appropriate for a senior person to be appointed to this role who has the autonomy to make these decisions on behalf of the contractor.

### *Voting and decision making protocols*

Subject to clause X.X.X, all decisions by the PAB will be by vote as follows:

- (a) each PAB Member (or substitute PAB Member) will be entitled to cast a vote;
- (b) all votes must be cast; and
- (c) every decision by the PAB must be unanimous — that is, it must be supported by all PAB Members.

This clause provides that the PAB members have an equal entitlement to vote and that each decision must be unanimous. Accordingly, the composition of the PAB (that is how many members the contractor has on the PAB) is crucial.

### *Duties of the PAB*

The duties of the PAB are to:

- (a) set policy and give philosophical direction for the alliance within the boundaries set out in this PAA;
- (b) appoint persons to the integrated management team (IMT) referred to in clause X.X, monitor the performance of the IMT and implement appropriate measures to correct undesirable trends;
- (c) set, review and revise limits of delegated authority as appropriate;
- (d) issue various directions, approvals and decisions as required by this PAA;
- (e) initiate and/or approve the commitment of reasonableness to the project and provide corporate support as necessary;
- (f) resolve any differences/issues that are referred to it; and
- (g) provide leadership and set a visible example for all to see of the alliance principles in action at a senior level.

The PAB has a wide brief. It sets policy and direction for the project. It is responsible for the appointment of persons to the IMT. It can issue directions. It can commit resources. It is responsible for dispute resolution. Accordingly, those

## THE ARBITRATOR & MEDIATOR JULY 2001

persons that the contractor appoints to the PAB need to be skilled in the appropriate areas.

### *Meetings of the PAB*

Prior to the date of practical completion, the PAB will hold a meeting at least every month.

The PAB will hold monthly meetings.

After the date of practical completion, the PAB will meet as often as is necessary to enable it to fulfil its duties under this PAA.

The PAB may meet after the date of practical completion.

### *Minutes of meeting*

The alliance participants will arrange for a secretary ('the PAB Secretary') who will attend all PAB meetings.

This is an administrative responsibility that is necessary.

The PAB Secretary will record all resolutions of the PAB and all actions arising out of each PAB meeting.

We have no comment in this regard other than to say that the contractor should ensure that it gets a copy of all of these resolutions and actions arising out of each meeting (and the minutes).

## ***Resolution of disagreements***

### *Procedure for handling disagreements*

The alliance participants will try to settle any alliance disagreement in good faith in a manner consistent with the alliance principles.

This poses an obligation of 'good faith' in respect to the resolution of disputes. Good faith is defined under the PAA (refer our comments above) and the impact that this duty has upon the resolution of disputes and the exercise of rights under the contract is a significant one.

## THE ARBITRATOR & MEDIATOR JULY 2001

If, despite their efforts, an alliance disagreement remains unresolved, an alliance participant, if it wishes to pursue the matter, may give written notice to each of the other alliance participants requesting that the alliance disagreement be considered by the PAB.

This clause provides for a method of ADR. What we mean by this is that a dispute may be referred to the PAB for consideration. This is in keeping with the standard alliance approach.

The PAB will consider any alliance disagreement referred to it and will give due consideration to submissions by all alliance participants, to any recommendation by the alliance project manager in respect of the alliance disagreement and to any other relevant information.

This clause provides for a number of things. Firstly it provides (by implication) that alliance participants will be able to make submissions to the PAB in respect of disputes. Secondly, it requires the PAB to have regard to these recommendations (and to those of the alliance project manager) and to 'any other relevant information'. The PAB will then make a decision. This is the only dispute resolution clause provided for under this contract. That said, the contractor needs to be aware that its rights in respect of resolving disputes by third party mechanisms (arbitration or litigation) will be limited by the operation of this clause. Certainly, the contractor will be required to go through this procedure before it has any consideration of other forms of dispute resolution.

### *No arbitration or litigation*

Except as provided in clause X.X.X below it is the intention of the alliance participants:

- (a) that the PAB will deal with any Alliance Disagreement and the Alliance Participants will do their utmost to ensure that the PAB is able to fulfil this crucial function effectively and efficiently;
- (b) that there will be no arbitration or litigation between the Alliance Participants on any Alliance Disagreement.

This clause purports to oust the jurisdiction of the court in respect of the resolution of any disputes that arise between alliance participants during the project. Clause (a) seems to us to impose an obligation of the parties to do

## THE ARBITRATOR & MEDIATOR JULY 2001

their very best to ensure the PAB can resolve a dispute. If the PAB is unable to resolve the dispute there is a bar upon any arbitration or litigation in respect of any 'alliance disagreement'. The 'alliance disagreement' is defined in Schedule 1 as 'any difference of opinion and/or conflict between the alliance participants arising out of the work under the alliance, the alliance works or this PAA'.

This is a very broad definition. This clause, on its face, catches any sort of dispute that might arise out of this project. We have some concerns as to whether or not agreements like this are enforceable. There is certainly case law which suggests that they are not (*Novamaze v Cut Price Deli* [1998] 1421 FCA). In any event, given the uncertainty, there is an equal possibility that it is enforceable. Such clauses in alliance agreements are yet to be tested. The contractor needs to be aware that by entering into an agreement such as this it may forgo any rights it has in respect of arbitration or litigation of disputes arising out of the project. This is a very important issue to consider when determining whether or not this agreement is commercially acceptable to you. One view is that some alternative (albeit limited) is preferred.

A failure by any alliance participant to perform any obligation or discharge any duty under or arising out of this PAA will not give rise to any enforceable obligation at law or in equity whatsoever save and except to the extent that the failure also constitutes an event of default.

This clause also purports to act as a bar to actions in respect of any breaches of obligations under this contract. The exception to this is an 'event of default'. Event of default is defined in Schedule 1 as follows.

An event of default is deemed to occur if an alliance participant:

- (a) commits an act or omission amounting to Wilful Misconduct in relation to any significant duty, obligation, term, condition or stipulation arising out of this PAA;
- (b) fails to take out or maintain an insurance policy that it is obliged to take out and maintain pursuant to clause X in accordance with the requirement set out in clause X;
- (c) fails to honour an indemnity expressly provided under this PAA;
- (d) refuses to rectify an alliance defect as directed under clause Y; or
- (e) refuses reasonable access for an audit referred to in clause Z.

## THE ARBITRATOR & MEDIATOR JULY 2001

An event of default is also deemed to occur if an alliance participant:

- (a) informs another alliance participant in writing or creditors generally that it is insolvent;
- (b) commits an act of bankruptcy;
- (c) has a bankruptcy petition presented against it;
- (d) is made bankrupt;
- (e) has a meeting of its creditors called with a view to:
  - (i) entering into a scheme of arrangement or composition with creditors;
  - (ii) placing it under official management;
- (f) enters into a scheme of arrangement or composition with creditors;
- (g) is subject to a resolution passed at the meeting of its creditors to place it under official management;
- (h) is placed under official management;
- (i) has a receiver of its property or part of its property apportioned;
- (j) is the subject of an application to a court for its winding up, which application is not stayed within 14 days;
- (k) has a winding up order made in respect of it; and/or
- (l) has execution levied against it by its creditors, debenture holders or trustees under a floating charge.

Wilful Misconduct means:

- (a) an intentional act or omission by an Alliance Participant carried out with disregard for the harmful consequences for another Alliance Participant, but does not include any error of judgment, mistake, act or omission, whether negligent or not, made in good faith by an Alliance Participant; or
- (b) failure by an Alliance Participant to make a payment to another Alliance Participant which has become due under this PAA.

Accordingly, on its face, the contractor may have some rights, for instance in circumstances where a project alliance participant goes into liquidation or becomes insolvent. In any event, this clause may also operate as a bar to actions and has very serious implications for the contractor. This is not an uncommon clause (indeed it is standard) in respect of alliance agreements, although it is clear that it will materially impact upon the contractor should any aspect of the project fall into dispute.

In our view there also must remain some degree of residual uncertainty as to whether the operation of the *Trade Practices Act 1974* (Cth) is excluded.

***Other important clauses***

Alliance contracts also contain clauses that typically:

- ensure the transparency of all payments made under the PAA;
- deal with the appointment of an external auditor who reports to the PAB — whilst the external alliance auditor will be the owner's agent, he or she will have access to the contractor's books and records in respect of the project;
- note that the contractor can also appoint the external auditor to act on its behalf to audit the owner's books;
- require the retention of records;
- give the terms of compensation, which usually consists of a three limb compensation model providing for the 'real' cost for work undertaken, a fixed lump sum for project and non-project specific overheads, and pain share/gain share; and
- provide a variation procedure, requiring standard forms and supporting information to be submitted to the PAB for review and possible certification.

***Risks to contractors***

The principal risks to contractors are:

- profit;
- disputes clauses ('no disputes'); and
- the need to be flexible.

***Benefits for contractors***

The principal benefits for contractors are:

- potential (higher than usual) profit;
- relationship building; and
- 'repeat' business.

***The obligation of good faith***

This obligation is one which has been growing in Australian law for some time. It is clear under an alliance that parties have an obligation to act in the

interests of another party (in certain circumstances) where that interest is in the best overall interest of the project (rather than their self-interest). This produces an interesting legal conundrum. Overlaid with the idea of good faith, this introduces an element of uncertainty to projects.

Good faith includes:

- being fair, reasonable and honest; and
- doing all things reasonably expected by the other party to the contract.

Sir Anthony Mason says he thinks it probable that the 'concept of good faith' embraces no less than three related notions:

- an obligation on the parties to cooperate in achieving the contractual objects (loyalty to the promise itself);
- compliance with honest standards of conduct; and
- compliance with standards of contract which are reasonable having regard to the interests of the parties.

The notion of good faith (and other equitable duties) that may be imposed by the courts when interpreting alliance agreements introduces considerable uncertainty into the project participants. This will be an area to keep a close watch on for the future.

## Conclusion

Alliancing represents an effort to increase the efficiency with which projects are delivered (through the use of 'commercial drivers') and to share 'risk and reward' between principals and contractors. The delivery structure has proven very successful and, in the appropriate project, should be given consideration. Nonetheless, for a contractor, entering in a project alliance carries with it substantial risk and it is imperative that contractors are alive to the risks prior to embarking on the alliancing adventure. ☼