SOCIETY OF CONSTRUCTION LAW

AFTER THE DIVORCE –
PROBLEMS WITH PARTNERING AGREEMENTS

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Six years after the Latham report recommended that modern construction contracts should include "a specific duty for all parties to deal fairly with each other, and with their subcontractors, specialists and suppliers, in an atmosphere of mutual co-operation" the industry now accepts that "construction companies that do not offer partnering frameworks will lose out on tenders"[1]. In 1999 around 20% of the market was engaged in partnering, with some contractors estimating that it brought in 40% to 80% of their work. 1999 also saw the first judicial opinion on the enforceability of partnering agreements in the first instance decision in *Birse Construction Ltd v St David Ltd*[2]. Academics and practitioners have long suggested that partnering agreements should be expressed to be non-contractual. However, following Birse, the courts may now use the provisions of a non-binding partnering agreement to interpret the conduct required of the parties under the substantive construction contract. This article examines the implications of this decision for parties who have already signed up to or are considering partnering agreements; and suggests that partners should beware of indirect enforcement of their agreements to co-operate.

Although employers and contractors may agree to partner over several projects in the long-term, or to a project-specific alliance, partnering agreements such as the recently released Standard Form of Contract for Project Partnering produced by the Association of Consultant Architects or the New Engineering Contract Partnering Agreement (which is at the consultation stage) generally have similar provisions. For example, an agreement to co-operate or to act in a spirit of trust, together with openness of communication and a mutual aim to complete the project on time and within budget form the core of most partnering agreements. The problem for the drafting committees may be that these agreements do not divide responsibility between the parties – since partnering is, by its very nature, co-operative. By contrast, clauses in the substantive construction contract are essentially divisive, stating the responsibilities of the contractor and those of the employer, but not generally (other than where partnering clauses such as clause 10.1 of the ECC are contained within the contract) including provisions which cover both parties. If, as this article goes on to discuss, the terms of partnering agreements may be implied into substantive contracts, this fundamental difference is the problem child which the partners may beget.

One further word of warning. Partnering agreements (especially long-term alliances) are designed to bring parties closer together. However, potential partners must beware of the various EU Directives on competition and of Article 81 of the Treaty of Rome (formerly Article 85) which regulate anti-competitive agreements and practices. Relevant UK legislation which partners should consider includes the Competition Act 1998. Where one of the partners is a public body, UK and EU regulations governing public procurement may also apply. A discussion of these issues is outside the scope of this article, but as the sanctions for anti-competitive agreements or behaviour are severe, it is especially important that partnering agreements do not affect or distort competition within the UK or EU.

Birse

Birse and St David signed a partnering charter in June 1997 under which they agreed to "produce an exceptional quality development within the agreed time frame, at least cost, enhancing our reputations through mutual co-operation and trust" – although the charter was expressly stated to be non-binding. This "exceptional quality development" was the construction of luxury apartments at Cardiff Bay. Both before and after the charter was signed the parties were negotiating the terms of the intended JCT 80 contract and Birse began work on the basis of a letter of intent sent by St David. Birse failed to sign or return the documents which they had been sent and the contract accordingly remained unsigned when the first phase was certified as complete. Birse subsequently abandoned the site, maintaining that no contract existed and that it was entitled to be paid for the cost of the work performed so far on a quantum meruit basis. The employer issued an application to stay the contractor's claim under section 9 of the Arbitration Act 1996, arguing that there was an agreed JCT contract and the dispute should be arbitrated in line with the JCT arbitration provisions. A stay is mandatory under section 9 unless the court is satisfied that the agreement was null and void, inoperative or incapable of being performed. The main issue in Birse was therefore whether there was a contract between the parties, and if so, whether it incorporated the JCT 80 terms, which formed the basis of the arbitration clause relied upon.

Lloyd J relied in part on the existence of the partnering charter to justify his decision to grant a stay. He found there was a contract on the JCT terms, even though there was "clearly no distinct offer and acceptance since the parties were converging by stages". In the absence of any evidence that a formal document was required, and in light of the agreement to co-operate contained in the charter, he inferred that the parties would not insist on technicalities, such as the execution of a formal document, as a prerequisite to the existence of a contract since "people who have agreed to proceed on the basis of mutual co-operation and trust, are hardly likely at the same time to adopt a rigid attitude as to the formation of a contract." The lack of a signed contract document could therefore be treated as unnecessary where the parties had agreed to co-operate and were therefore unlikely to insist on the need for formal documents.

Although Lloyd J's decision was overturned on appeal (both in the Court of Appeal on the basis that it should not have been made on affidavit evidence and when remitted back to the Technology and Construction Court on the basis that although the essential terms had been agreed, the parties had not intended to become contractually bound until St David had reviewed of the contract to deal with "minor inconsistencies") neither court dealt substantively with the partnering charter. The first instance decision in Birse therefore stands as the best guideline to the courts' approach to partnering for the time being. Having said that, the principles that can be determined from the first instance decision in Birse are unclear. It may be that the courts will imply terms: (1) to govern the parties' conduct outside the substantive construction contract; (2) into the contract itself – to the effect that the parties will act under that contract in a way that is consistent with the spirit of the partnering agreement; or (3) to govern variations to the contract.

Another possibility is that the partnering agreement will bring the parties within a special relationship, which would imply they had to act with good faith towards each other.

The third suggestion explored in this article is that the principles of partnering will be used to govern interpretation of the substantive contract terms, and that these terms will be construed in light of the principles adopted by the partners.

Implying standards for conduct outside the contract

One of the aspects considered at first instance in Birse was the issue of the parties' conduct outside the construction contract. The employer raised the argument that the contractor's representative lacked authority to enter into a contract. Lloyd J considered that, having signed up to act with "'mutual co-operation and trust'…and 'to promote clear and effective communication," the employer would have expressed his concerns at the time they arose. "The terms of that document, though clearly not legally binding, are important for they were clearly intended to provide the standards by which the parties were to conduct themselves and against which their conduct and attitudes were to be measured." That is, having agreed to co-operate, one party could not suddenly argue lack of authority, having failed to raise the issue at a stage when co-operation could be expected.

A similar case might arise where the parties committed themselves in the partnering agreement to agreeing, say, a project timetable to be incorporated in the substantive contract. What would be the effect of one party delaying its agreement, or proposing a wholly unworkable timetable?

The case of *Phillips Petroleum Company UK Ltd & others v Enron Europe Ltd*[3] provides a useful parallel. Phillips agreed to sell natural gas to Enron. As a prerequisite to the sale, Phillips had to construct a pipeline from the gas fields to the shore and Enron to build on-shore facilities for receiving the gas. As these could only be commissioned jointly, the agreement obliged both parties to co-ordinate their construction schedules to achieve completion at approximately the same time and to use "reasonable endeavours to agree as much in advance as possible" the commissioning date. When the price of gas subsequently dropped, Enron refused to agree a commissioning date. The court found that, although a term requiring a party to use its best endeavours to agree was generally not enforceable in the absence of objective criteria for agreement (*Little v Courage Ltd*[4]), in this case Enron's failure to agree was inconsistent with its agreement to use reasonable endeavours to agree, and was therefore actionable.

The applicability of this decision to partnering seems clear and may mark a departure from the accepted principles that the court will not generally recognise an agreement to agree. Where the parties have agreed to co-operate, even more so than where they have merely agreed to use reasonable endeavours to agree, the courts will not look favourably on failure to take a genuinely co-operative attitude to the point requiring agreement.

Implying the principles of partnering into the construction contract

Is it possible to interpret the effect of Birse to mean that the court will find it easier to imply a term into the construction contract that parties are bound to act under the contract in accordance with the principles of partnering, if they have previously committed themselves to these principles? The comment in Birse that the principles of

partnering "provide the standards by which the parties were to conduct themselves" suggests that this interpretation is possible and that adherence to these standards can be implied into the construction contract. If this is so, arguably, if parties have signed up to a partnering charter, the subsequent contract cannot be inconsistent with its principles. If the parties have agreed to act reasonably, they must act reasonably under the subsequent contract. If the parties have agreed to co-operate they must not do anything inconsistent with the obligation to co-operate.

For example, reasonable conduct might require the employer to allow an extension of time or prevent it from activating provisions for liquidated damages when external circumstances make completion within the contractual deadline difficult as opposed to impossible (contrast the rules on frustration where only impossibility discharges a contract). Although not required to decide this, Lloyd J commented in Birse that the contractor put forward the contract programme which was "obviously within the 'partnering' ethos [and therefore] which it was expected would naturally have led to a sympathetic approach [from the employer] to questions of extensions of time and deduction of damages for delay if [the contractor] had not been able to maintain the programme because of…reasons beyond its immediate control, such as being let down by a supplier or a sub-contractor." This is also clearly relevant to the enforceability of an employer's agreement to vary the contract to allow extra time in the absence of consideration from the contractor, discussed below.

The effect of the partnering agreement on exclusion clauses

Another way in which the principles of partnering may be implied into the construction contract is in determining the validity of any exclusion or limitation clauses. Whether an exclusion or limitation clause will be enforceable is dependent on what it attempts to exclude. Some clauses are automatically unenforceable, such as those excluding liability for death or personal injury. Others may be enforced if the clause is fair and reasonable under section 3 of the Unfair Contract Terms Act 1977 (which applies to written standard terms of business – including those which predominate in the construction industry). The circumstances to be taken into account when determining whether the clause is reasonable are those which were known or should reasonably have been known by the parties at the time when the contract is made (section 11(1)). The time at which the clause becomes "activated" i.e. when liability arises, is irrelevant. At the time the construction contract is made, one of the circumstances known to both parties is that they have entered into a partnering agreement. Where it subsequently falls to the courts to consider whether a particular exclusion or limitation clause is reasonable, in addition to the factors normally taken into account, a clause which is deemed to be inconsistent with the tenor of the partnering agreement may be unreasonable for the purposes of UCTA.

The contra proferentum rule – that the clause will be interpreted against the party at whose insistence it is inserted into the contract and who seeks to rely on it – supports this contention. The party seeking to rely on the clause will not only have to overcome this hurdle, but must show that the clause is reasonable, even given its existing agreement to co-operate with the other party. As clauses seeking to exclude or limit liability are, by their very nature, not co-operative, the courts may find them less reasonable where the parties have previously entered into a partnering agreement.

This is not such a contentious proposition as might first appear. Courts have found that events and conduct preceding the contract determine the question of reasonableness. In S*t Albans City & District Council v International Computers Ltd*[5] the fact that one party was pressured by the other and by circumstances into expediting its agreement to the contractual terms made it unreasonable to allow the other party to rely on those terms. An analogy can be drawn between the pressure to expedite the contract's execution for economic reasons in St Albans and the pressure inferred by the implication that the party who did not agree the contract containing the exclusion clause would not be acting in accordance with its partnering obligations. A pre-contractual expression of co-operation might therefore impose a similar "pressure" to agree to the exclusion clause as not to do so may not be co-operative.

The agreement to co-operate and its effect on variation of contract

The law requires co-operation between parties in the sense that they perform the contract according to its strict terms. But co-operation between business contractors often implies a degree of flexibility, that they will not insist on strict contractual rights, that they will make concessions in times of difficulty. Minor variations to the contract may go unchallenged. But what is the position if a variation in the terms of the contract is agreed informally or simply arises out of performance of the contract in a different way, where the other party accepts this difference in performance without protest. Where consideration is given for the variation clearly it is binding even if the consideration in question is tenuous (*Williams v Roffey Bros. & Nicholls (Contractors) Ltd*[6]). In the absence of consideration the variation is not normally enforceable unless it can be implied that a party agrees to the variation because it is reasonable and necessary to do so.

Suppose, for example, that market conditions make construction more difficult or less profitable than envisaged at the time of the contract. An insistence on strict compliance with all contractual terms effectively destroys co-operation in such circumstances. Does it follow that a prior expression of co-operation requires the employer to share the risk or to agree to changes which relieve the contractor from some of the burdens (including liquidated damages) brought about by changes in market condition such as a labour dispute or shortage / inflationary increase in the price of raw materials? Clearly an employer would not wish to commit itself in this way, but the law may be moving towards a position where co-operation between the contracting parties imposes other obligations, one of which is to agree to alterations which are commercially necessary given the prevailing market conditions.

The completion of the second runway at Manchester Airport is a recent example of the operation of partnering. When weather difficulties delayed completion of the earthworks, the contractor was potentially facing a liquidated damages claim for £250,000 per week. However, the employer agreed to vary the contract to waive its right to these damages on the basis that the contractor could reduce the projected delay from nine months to four. Although in this case the project was successfully completed, if the employer's agreement to the variation was made in the context of a partnering agreement, it would theoretically be precluded from arguing that the variation was not binding even if the contractor provided no consideration.

The special relationship of partners – duty to act in good faith and to conduct themselves in a way conducive to maintaining confidence and trust.

Numerous articles have dealt with the implication of a duty to act in good faith, and this one does not propose to repeat their conclusions. In essence, English law will not normally imply a duty of good faith in the absence of a special relationship between contracting parties. The rationale for implying terms into contracts has been described in case law in various ways – sometimes relying on the officious bystander to ascertain what the parties must have intended but not expressed at the time of the contract, sometimes justifying the inclusion of a term on the grounds of business efficacy – that the term is both reasonable and necessary to make commercial sense of the agreement between the parties (presumably because the parties as reasonable and business-like people would wish to negotiate on such a basis). Probably a combined approach will be used so that a term will be implied when it is reasonable and necessary to give business efficacy to the contract (*Trollope & Colls Ltd v North West Metropolitan Regional Hospital Board*[7]).

Courts do not rewrite contracts, but they interpret terms in order to preserve the reasonable expectations of the parties. In doing so, they assume that they are giving effect to the true but unexpressed intentions of the parties. In construction contracts, courts have implied terms that the parties will conduct themselves in such a way as to allow the contract to be carried out in a reasonable manner. Thus it may be implied that the employer will not hinder or prevent the contractor in the performance of the contract. (*Davy Offshore Ltd. v Emerald Field Contracting Ltd*[8]). Business efficacy might justify the imposition of certain obligations consistent with the spirit of the partnering agreement. That is, the court will assume that terms are included in the contract which will give effect to the presumed intention of the parties. A partnering agreement is just such an expression of the parties' intention. In essence it expresses the parties' intention to act in good faith and reasonably, as co-operation rests on such concepts. Hence the courts may imply a term to the effect that the parties will act reasonably and in good faith.

An implied obligation to act reasonably has frequently been used to narrow the effect of contractual terms; so that one party's express contractual right is subject to an implied requirement that it does not exercise that right unreasonably. In the context of partnering agreements, reasonable conduct is likely to require a party to adhere to the standards set by the pre-contractual partnering agreement. If this is so, a party may be denied the right to pursue certain of his contractual rights simply because it is unreasonable in the circumstances to do so and thereby constitutes a breach of an implied term. It is clearly reasonable to require parties to conform with the provisions of their own partnering agreement. Whether it is "necessary" to imply such a duty is a moot point. Arguably it is necessary to make business sense of the contract to imply a term that parties who have negotiated on the basis that they will co-operate, will in fact do so reasonably and in good faith.

The courts have not been slow to imply terms of good faith and mutual confidence and trust in employment contracts. For example *Woods v WM Car Services (Peterborough) Ltd*[9] held that "employers will not…conduct themselves in a manner calculated or likely to destroy or seriously damage the relationship of confidence and trust between employer and employee" and subsequently made it clear that this implied duty is

imposed on both parties to the contract of employment. It follows that each party must treat the other reasonably and with respect. Its actions must not be inconsistent with this obligation.

In *Bedfordshire County Council v Fitzpatrick Contractors Ltd*[10] Dyson J was asked to consider whether reciprocal duties of trust and confidence could be implied into a 4 year contract for highway maintenance. Having contracted out the maintenance to Fitzpatrick and transferred its workforce to Fitzpatrick, the Council failed to place sufficient orders to justify the cost of the transferring employees and Fitzpatrick sought to defer and later to terminate the contract. The circumstances required the court to consider whether the contract contained an implied term of trust and confidence and whether Fitzpatrick's failure to start work was in breach of this term.

Dyson J dismissed counsel's suggestion that as the contract was for the provision of continuous maintenance services, rather than for a single engineering project, the relationship was analogous to that of employer and employee and therefore the court should imply a term of trust and confidence. The court should be slow to imply general or widely worded duties in cases where the contract contained numerous detailed express terms, and "in such a case, the court should only do so where there is a clear lacuna." There was no such lacuna in this instance. The parties had taken "a great deal of trouble to spell out with precision and in detail the terms that were to govern their contractual relationship" and there was therefore no scope for him to imply a general term requiring mutual trust and confidence.

It is clear from Bedfordshire that the courts are not usually willing to imply a duty to act in a good faith or in a way conducive to mutual confidence and trust outside accepted 'special relationship' cases such as employment and insurance, even where the contract provides for long term continuing obligations. Parties to a construction contract are not normally in a special relationship of this sort but may be deemed to be so because they agree to co-operate and to act with mutual trust and confidence. If this is so, the relationship begins to resemble the types of relationship where the courts have implied duties of reasonable conduct and good faith and an obligation could be imposed on the parties not to do anything which destroys the co-operative relationship arising from the partnering agreement.

Using partnering to interpret terms in the substantive contract

Lord Hoffman addressed the issue of interpretation in *Investors Compensation Scheme v West Bromwich Building Society*[11]. In this case he relied on the background to a contract to determine how it should be interpreted, where the background was anything that was reasonably available to the parties and "which would have affected the way in which the language of the document [contract] would have been understood by a reasonable man". The terms of a partnering agreement that is not itself enforceable is just such background. As the parties' commitments are mutual the partnering agreement is unlikely to be a declaration of subjective intent which was one of the two matters Lord Hoffman excluded from his definition of contractual background, the other being evidence of negotiations.

As “background” the existence and terms of the partnering agreement will affect the meaning of any contractual document that the parties enter into. This is a key principle as “the meaning of the document is what the parties using those words against the relevant background would reasonably be understood to mean. The background may not merely enable the reasonable man to choose between the possible meanings of words which are ambiguous but even (as occasionally happens in ordinary life) to conclude that the parties must, for whatever reason, have used the wrong words or syntax.”

In the construction context, ICS has been used to incorporate the ICE guidance notes into the substantive contract (*Matthew Hall Ortech Ltd v Tarmac Roadstone Ltd*[12]). The effect of ICS in the context of partnering might be that if the construction contract contains terms that are incompatible with co-operation provisions in a partnering agreement, the courts can choose a meaning for those terms which is compatible with the background of the parties’ agreement to co-operate.

Enforcing the partnering agreement itself

The courts have not yet had to consider the enforceability of the partnering agreement itself as most partnering agreements are expressed to be non-binding, or, if contained within the substantive construction contract are likely to be too vague to be enforceable.

However, whether contained in a separate agreement or incorporated in the substantive contract, the enforceability of partnering clauses may soon come before an adjudicator. This does not seem surprising if the terms are contained in the construction contract itself, but even if the parties enter into a separate partnering agreement, this may qualify as a construction contract under the *Housing Grants Construction and Regeneration Act 1996*. A construction contract is widely defined in section 104(1) as an agreement for (inter alia) the carrying out of construction operations or arranging for the carrying out of construction operations by others, whether under sub-contract or otherwise. If the parties agree in the partnering agreement to a governing mechanism for the construction contract, the partnering agreement may itself be a construction contract for the purposes of the Act. Even if no formal contract was concluded (as in Birse), the parties could well find themselves before an adjudicator, either under the agreed dispute resolution mechanism (if this fulfils the requirements of the Act) or under the Scheme for Construction Contracts.

Because the allocation of risk is a central area for construction contracts, everything discussed in this article so far might indicate that partnering agreements are to be avoided at all costs if there is even a possibility of an adjudicator or court disrupting this allocation. However, there is a strong argument for expressly stating that partnering obligations are binding and making them sufficiently certain to be enforceable. This will avoid the unforeseen effects experienced by the parties in Birse, since the agreement will have been drafted in the full knowledge that it may later be adjudicated or litigated.

In addition, an enforceable partnering agreement could be used to incentivise parties for mitigating events at the other party’s risk. This is perhaps the best way of achieving the objectives in the Latham report and for “shared financial motivation to pursue those objectives”.

Conclusion

Parties to a partnering agreement – beware. An expression of your intention to co-operate may have the undesired effect of diluting the protective certainty which you aimed to achieve by including specific terms in the construction contract. Reliance on liquidated damages, exclusion or force majeure clauses, and even the defence of frustration may be disallowed if, in the circumstances, such reliance would derogate from the spirit of the partnering agreement.

What can you do about this? If the aim is to make the partnering agreement binding, the provisions should be clear, precise and mutually enforceable to satisfy the requirement for consideration in all contracts. Usually the agreement is expressed to be non-binding. But a party may find that in the hands of a court a non-binding expression of co-operation gives rise to unintended legal consequences. A party who wants to avoid duties being implied into the construction contract should go further and explicitly state in the contact that the partnering agreement has no legal effect in general and specifically that it has no legal effect on particular contractual rights. This should have the effect of making the parties' intentions clear and thus negating any inference that a party, acting in a spirit of co-operation, will not insist on these contractual rights. Whether this will be effective is unknown – but clearly a party who expresses such an intention in the contract is in a better position than one who does not. However, just as a purchase of property "subject to contract" confers no legal obligations, a partnering agreement which has no legal force is arguably a meaningless document.

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[1] "Partnering in the Construction Industry" June 1998
[2] [1999] BLR 194
[3] LTL 12/10/96
[4] (1994) P&CR 469
[5] TLR 11/11/94
[6] [1991] 1 QB 1
[7] [1973] 2 All ER 260
[8] (1991) 55 BLR 1
[9] [1981] ICR 666
[10] (1998) CILL 1440
[11] (1998) 1 WLR 896
[12] (1998) 87 BLR 96