ALLIANCING IN DELIVERY OF MAJOR INFRASTRUCTURE PROJECTS AND OUTSOURCING SERVICES IN AUSTRALIA — AN OVERVIEW OF LEGAL ISSUES

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1. INTRODUCTION

1.1 Types of alliances

In recent years, there has been a rapidly growing trend to style business relationships as "alliances". The term, however, covers a multitude of sins in practice, and all that can be said with absolute certainty is that, in each case, the relevant alliance contract (assuming there is one!) requires careful scrutiny to ascertain just what sort of legal "animal" or relationship has been created. The type of alliance entered into often depends on the industry (from airlines to IT, oil and gas to construction) involved. Alliances range from full blown joint ventures for one-off projects to enhanced long-term supplier outsourcing relationships or alliances.

This paper deals with alliances between contractors and suppliers for delivery of major projects and for outsourcing of services. Traditionally, principals have paid contractors a straight lump sum fee or on a schedule of rates, for services or goods supplied. In some industries, these long-established contracting bases are being replaced by enhanced principal/contractor relationships, with joint decision-making replacing traditional direction by an owner or his superintendent, and towards greater sharing of risks and more sophisticated and complex rewards/sanctions structures.

Alliancing began in the construction industry, with its roots in North Sea oil and gas projects. British Petroleum's experience with the Andrews Field project in the North Sea shows how major oil companies and major construction companies work and benefit together from an alliance relationship. In that project, BP formed an alliance of seven partners to plan and execute the development which resulted in cost savings of 20 to 30% and time savings of six months.

Alliances in outsourcing are also becoming increasingly common including in areas such as accounting and finance, logistics, facilities

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management, maintenance and for engineering and planning development activities.

1.2 Structure of paper

This paper discusses some important legal issues for consideration when entering into alliances and preparing alliance contracts for major projects and outsourcing services in Australia. It does not deal with the detail of structuring the remuneration model and key performance indicators which leading alliance practitioners have already covered in various papers.[1]

In section 2, risk allocation and structures for project alliances and strategic alliances are reviewed.

Section 3 deals with legal issues which must be considered when entering into an alliance. The concepts of good faith and fiduciary duties, and their impact on other aspects of an alliance contract such as obligations to keep accounts on an "open-book" basis and the right to terminate for convenience, are considered. The "wilful default" concept, which is a salient feature of many contracts used for project alliances, is considered in detail.

Section 3 also deals with an owner's statutory responsibilities and liabilities in the context of their participation in an alliance, and with ownership of intellectual property created by the alliance. The roles and duties of public sector agencies in alliances are also considered.

Section 4 deals with legal structures that support successful alliances (including consideration of the suitability of standard form contracts) and the role of project financing in alliancing projects.

2. RISK AND ALLIANCE STRUCTURE

2.1 Risk profile and management in traditional and relationship contracting structures

Risks are unavoidable in the delivery of any project. A project owner's exposure in delivering a project, and the risks that an owner is prepared to assume, depend on the owner's risk management strategy. A sound risk management strategy will include:

- risk identification and quantification;
- evaluating the range of possible outcomes and the likelihood of the occurrence of each risk; and
- identifying risk transfer and/or mitigation measures.

Traditionally, in major projects or projects involving project financing, the

[1] See e.g. J Ross, "Introduction to Project Alliancing", paper presented at the PCI Alliance Contracting Conference, Sydney 30 April 2003.

most common approach is for project owners to enter into fixed time/fixed price "turnkey" contracts for the delivery of the project so that the risk of cost overruns, and delay risks and (depending on the ownership of technology used in the project) technology risks, are passed to the contractor. The owner would normally look to effect insurance for those risks which the parties are unwilling to assume.

The transfer of risks to other parties inevitably leads to increases in the project costs because contractors seek a higher return on investment for assuming a "higher" level of risk under the contracts or because of increased insurance premiums.

Alliance contracting is a form of relationship or relational contracting[2] and departs from the traditional approach to contracting with respect to risk allocation.

The Australian Constructors Association has defined "relationship contracting" as "a process to establish and manage the relationships between the parties that aims to remove barriers, encourage maximum contribution and allow all parties to achieve success".[3] It identifies a number of key issues relating to alliancing:

> "Clients and contractors are best served when the delivery strategy utilised suits the project requirements."
> "Many clients still utilise project delivery systems structured to alter the allocation of risk and neglect the opportunities to be gained through improving the relationship between the contracting parties."
> "For larger projects, where there are many unknowns and uncertainties, the client can better manage its risks through a more cooperative approach where the risk is embraced rather than transferred."
> "Where an examination of the risk allocation indicates that a risk embrace approach will be more suitable, an alliance offers the parties a technique to ensure that the goals of the client and contractors are more closely aligned within a gain-sharing/pain-sharing framework that balances risk and reward and focuses all parties on an optimum project outcome."
> "An alliance requires the parties to become result focused and willing to challenge conventional standards. The focus is on a cooperative endeavour to improve project outcomes rather than establishing a legal regime to penalise non-conformance."

Some other reasons given as perceived advantages of the alliancing approach include:

- flexibility to vary development concepts while maintaining schedule and cost;
- joint owner/contractor approach to safety and environmental objectives;
- non-adversarial approach with common, rather than conflicting, project objectives;

[2] Other forms of relationship contracting include "partnering", incorporated and unincorporated joint ventures, etc.

[3] Australian Constructors Association, *Relationship Contracting—Optimising Project Outcomes*, 1991.

- reduced project management costs due to fewer contracts and interfaces and an integrated team;
- reduced bidding time and costs; and
- flexible access to the contractor's resources avoiding the need for the owner to develop a large in-house engineering group.[4]

In "straightforward" projects where the risks are traditionally manageable, an alliance is probably not appropriate.

2.2 Types of alliances

Alliancing was first used in Australia in the 1980s on the Wandoo and East Spar offshore gas projects. The operator of the Wandoo oilfield constructed and installed the Wandoo B platform using an alliance with four construction and design companies. In the East Spar project, there was an alliance between the operator and engineering/construction contractors for the design and construction of two subsea wells, a subsea gathering system and multiphase pipelines. Since those offshore projects, alliancing has been used on other infrastructure and service areas including process plants, roads, dams, railways, water and sewerage treatment plants.

Broadly speaking, alliancing can be categorised into the following:

- "pure" or "project" alliances, which include projects such as Sydney Water's Northside Storage Tunnel Project and Priority Sewage Project, the Queensland Clean Fuels Project, the National Museum of Australia Project, Western Australian Water Corporation's Woodman Point project and a number of road projects by the Queensland Department of Main Roads including the Georgina River Bridge and the Port of Brisbane Motorway. These types of alliances are also increasingly being used in New Zealand including the Freeflow Alliance road project in Auckland and the Project Aqua hydro-electric project; and
- "impure" or "strategic" alliances, which include outsourcing of major rail infrastructure capital and maintenance works by the then NSW Rail Access Corporation, State Rail Authority of NSW and BHP Steel, of facilities management by NSW Police, Alcoa, and Incitec, of EPC and maintenance services by Santos, and the TVR telecommunications project in New Zealand.

2.3 "Pure" or "project" alliances

A "pure" or "project" alliance typically includes the following key features[5]:

- The parties are collectively responsible for performing the work and

[4] P Campbell and D Minns, "Alliancing—The East Spar and Wandoo Projects", 15(4) *AMPLA Bulletin*, 202.

[5] J Ross, *op. cit.* n. 1.

generally assume collective ownership of all risks associated with delivery of the project.

- The project owner pays the non-owner project participants for their services on a 100% open-book compensation model which covers the project costs and project-specific overheads, a fee to cover corporate overheads and "normal" profit, and an equitable share of the "pain" or "gain" depending on the project outcomes compared with the parties' joint targets. The downside to the non-owner project participants is usually limited to the loss of the corporate overheads and normal profit.
- The alliance leadership is through a joint body (typically called the Project Alliance Board or Alliance Leadership Team) comprising senior representatives of the project owner and non-owner project participants, of which all decisions are unanimous.
- Day-to-day management of the project is by a joint management team (typically called the Project Management Team or Alliance Management Team) and supported by various seamless integrated project teams where all project members are chosen and allocated tasks on a "best for project" basis.
- The parties agree to resolve issues or disputes within the alliance (by escalating up to the project alliance leadership) with no recourse to litigation except in the case of "wilful default".[6]

2.4 "Impure" alliances

These are similar to the "pure" alliances in terms of management structure (such as use of alliance boards, alliance management teams and integrated project teams), remuneration structure (such as performance-based payment structure based on use of key performance indicators (KPIs)) and express obligations of the parties to work co-operatively and in good faith.

However, in "impure" alliances, the non-owner alliance participants (rather than all alliance participants) typically retain discrete liability for breach of their obligations under the alliance contract, and are specifically obliged to discharge those obligations under the alliance contract. In these and other respects, these types of alliances retain more of the features of traditional contracting than is the case with "pure alliances", relying on the management and remuneration structures adopted to drive alliance-style behaviours, but with a less radical approach to risk assumption and liability.

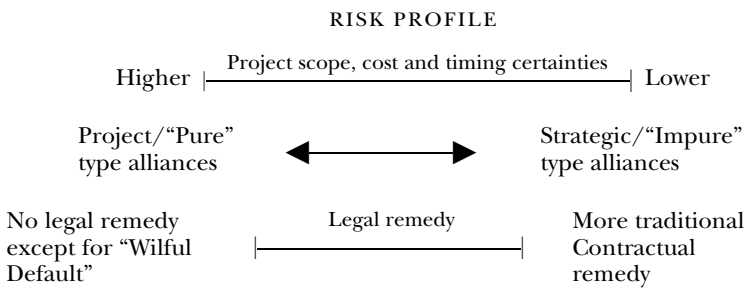
This type of alliance is generally used more for projects or situations where the parties are better able to identify, assess and quantify the risks assumed. They are more generally used for conventional construction

[6] The concept of "wilful default" and its legal implications is discussed further in section 4.4, below.

projects (as compared to the more "risky" projects such as offshore platforms or where the project alliance participants are working under severe time and delivery constraints) and for outsourcing of services (such as plant maintenance, facilities management, and rail infrastructure maintenance).

2.5 Risk spectrum

The diagram below shows the risk spectrum for the different forms of alliancing.



As mentioned above, each alliance contract needs to be carefully reviewed to ascertain to what extent it sits at or towards the "pure" or "impure" end of the risk spectrum.

2.6 "Strategic" alliances—long term

A strategic alliance is a business relationship between organisations in which they share risks, pool strengths or integrate business functions for mutual benefit but remain distinct entities. These alliances are becoming more common.

Principals see these alliances as a means by which they can reduce their reliance on in-house resources by utilising the expertise of contractors in the principal's business plans (allowing them to concentrate on their core business) but allowing principals to have a more significant input into the non-core activities than would be the case with traditional, "arm's length" outsourcing. In addition, the parties normally repeatedly apply the principal's life cycle objectives to evaluation and decision making during the implementation of the project.

For contractors, strategic alliances provide a mechanism by which they can forge closer, longer-term relationships with customers, often on more sensible, lower risk terms that still provide the opportunity for good profits (and often incumbency, rather than constant and costly retendering) as rewards for excellent performance.

The development of strategic alliancing can be viewed in part as an enhanced outsourcing arrangement where the relationship strengthens over

time as communication improves and trust is enhanced between the alliance partners.

The structures of strategic alliances are more aligned towards an "impure" model, as a number of the risks can be more easily assessed and quantified allowing contractors to assume these risks without putting a "high premium" on assuming those risks.

2.7 Value for money

In choosing the appropriate form of delivery structure, an important question is whether the parties will deliver "value for money" and, if so, how to optimise that value.

In a recent performance audit report on the Northside Storage Tunnel Project,[7] the New South Wales Auditor-General stated that

> "the concept of an alliance offers the promise of a successful outcome. But it brings its own risks. One is the risk of not getting the incentives and sanctions right. Another is that the parties become too close. The 'owner', the party who initiates, and will ultimately own, the project, needs to ensure that the alliance delivers *value for money*. An alliance should not compromise the principles of accountability and transparency that are so integral to the public sector."

Generally, the major factors considered when assessing value for money in public-private partnership programmes are:

- risk transfer—relieving the government of the substantial, but often undervalued, cost of asset-based risks;
- whole of life costing, fully integrating up-front design and construction costs with on-going service delivery, and operational, maintenance and refurbishment costs;
- innovation—providing wider opportunity and incentive for innovative solutions as to how service requirements can be delivered; and
- asset utilisation—greater opportunities to generate revenue from use of the asset by third parties (which may reduce the cost that government would otherwise have to pay as sole user).[8]

To optimise risk allocation, where a party is able to control a risk, either by limiting the likelihood that it will occur or limiting the consequences if it does, it may be better for that party to assume the risk than a party with no control over it. For both pricing and management reasons, *optimal risk allocation dictates that particular risks are allocated in line with the capacity to control and manage at least cost.* This proposition is more applicable to the strategic

[7] Auditor-General's Report, *Performance Audit, Sydney Water Corporation, Northside Storage Tunnel Project*, July 2003.

[8] In Partnerships Victoria projects, bids are assessed against benchmarks to ensure value for money, as compared with the cost to government to deliver the project itself. The Public Sector Comparator benchmark can be used to calculate the full, risk-inclusive cost of providing the service over the life of the project. Other factors such as non-quantitative risks in the proposed service levels and capabilities are taken into consideration in the overall assessment.

type alliances (as compared with the "pure" project type alliances where risks are shared and managed by all the project alliance participants, rather than transferred to the party best able to manage them).

As stated in the Partnerships Victoria document, one risk which cannot be allocated to the private sector is that government may contract with an unsuitable partner. The primary issue is whether a relationship between the government and the private sector can be sustained over the long term. The ingredients of a successful relationship include:

- planning and specification—so that the government's desired outcomes and output specifications are clear to the market;
- a genuine and viable business opportunity for the private sector;
- certainty of processes—so that tender conditions are clearly understood before the project proceeds;
- balanced bid evaluation—based on more than simple financial comparison;
- clear contractual arrangements—centred on key performance indicators so as to promote performance and minimise disputes; and
- recognition of the partnership—to encourage good faith and goodwill between the government and the private sector in all project dealings.

The same issues apply to private sector owners and contractors.

Subject to the qualification noted above concerning "pure" project type alliances, the "value for money" proposition is consistent with the alliancing principles discussed earlier.

3. IS THERE A NEED FOR CONTRACTS?

3.1 Requirement for a contract

Although it has been asserted by some commentators that contracts are not an essential part of the alliance relationship, the prevailing view is that contracts are necessary.[9] The alliance contract can be specifically tailored to reflect the special nature of the alliance relationship in any industry.

An alliance contract should assist the effective operation of the alliancing relationship while remaining sensitive to the project risks. A contract which seeks to minimise the principal's risk exposure by shifting all risks to the contractor will hamper the development of the climate of goodwill and fair dealing conducive to a long-term relationship.

Entering into an alliance relationship does not mean that the integrity of the risk allocation between the parties need necessarily be affected. Rather,

[9] E.g. J Ross, *op. cit.* n. 1. D Dombkins, *Governance Contracting—Leading the Way* (unpublished).

the contract should provide the machinery appropriate to reflect the parties' real intentions concerning the alliance relationship (whether in the "pure" or "impure" models).

In public sector contracting, it is important that the contract shows transparency of the contracting process, for public accountability reasons.

Public sector organisations must address not only probity concerns, Auditor-General audits and ICAC type review when contracting out, but also must show compliance with codes of practice established by various governments (which deal with issues such as industrial relations, commitment to best practice, continuous improvement and the like).

3.2 Structure of alliancing contractual arrangements

Contractual arrangements for alliancing projects are typically based on one of the following structures:

(a) an all-encompassing alliance contract which covers all the project alliance participants' rights and obligations; or
(b) an umbrella alliance contract which deals with certain key alliance matters but anticipates separate works contracts between the owner alliance participant and each of the other non-owner project alliance participants. The latter forms of contract deal with each parcel of work for the project (whether design or construction).

The first of these two contractual structures is now the one more commonly used. The latter contractual structure has been used on the East Spar project, the Queensland Clean Fuels project and the Asset Control Enhancement project by Santos.

4. LEGAL CONSIDERATIONS IN AN ALLIANCE CONTRACT

4.1 Structure of alliance contracts

Alliance contracts generally exhibit the following features:

- a management, reporting and issues resolution structure comprising an alliance board, an alliance management team(s) and integrated process/development teams;
- an obligation on the alliance participants to act reasonably and in good faith;
- for "pure" project alliances—no actionable legal liability for alliance participants (except in the case of wilful default);
- a performance-based remuneration structure linked to key performance indicators, comprising a "cost plus fee" approach on an "open-book" basis;
- a right for the owner/principal to terminate for its own convenience; and

- a *force majeure* clause.

When drafting an alliancing contract, the following issues should be considered:

- fair and equitable risk sharing (having regard to the nature of the project, outsourced services and type of alliancing structure);
- common objectives;
- a closer party/party relationship than that assumed by traditional industry standard general conditions of contract;
- ensuring the contract works effectively as a management tool, allowing where possible better management of the contractual and broader business relationship; and
- risk allocation/sharing in the context of delivering increased value for the alliance project participants if the performance standards are met.

An alliance contract should be drafted in a way which allows joint collaborative effort to reach mutually rewarding goals. It should emphasise the positive aspects of the relationship and attempt to relegate strict legal issues to the background.

However, the fact remains that the contract creates (and sometimes modifies) legal rights and obligations and it is important to understand the nature and significance of those legal relations.

The core of any alliance contract is a series of commitments to behave in a manner consistent with the alliance principles set out in the contract itself or in an associated alliance mission statement.

These principles may include commitments similar to the following:

> "to produce outstanding results in the successful execution of the work in the Project Alliance Agreement";
> "to establish and maintain an environment which encourages honest, open and timely sharing of information and a willingness and desire to consider and implement new ideas in order to create a mutual winning position for the Project Alliance Participants";
> "to share and transfer such behavioural aspects to all persons associated with the work under the Project Alliance Agreement in order to achieve maximum success in all respects";
> "to avoid disputation or litigation" or "to notify each other of perceived or real differences of opinions or conflicts of interest immediately they arise and to strive to resolve such difference or conflicts without any form of claims or litigious action."[10]

4.2 Legal nature of relationship—do the parties owe each other fiduciary duties?

In traditional contractual arrangements, each party has particular contractual obligations and enjoys particular contractual benefits. Normally, the contractor must perform certain tasks such as to design, construct, commission or operate and maintain (as the case may be), and the principal must perform certain tasks such as payment obligations.

[10] Extract from an alliance mission statement in an actual alliance contract.

In pure alliances, the project alliance participants typically "associate themselves in an innovative manner so as to produce outstanding results in the execution of work under the Project Alliance Agreement". The project alliance participants agree to participate in a common venture based on co-operation. The project alliance participants agree to "work under the Project Alliance Agreement so as to ensure that the Works are in accordance with the Project Alliance Agreement and fit for their intended purpose".

Recently, for example in the alliance contract for the Project Aqua project in New Zealand, the concept of collective co-operation and responsibility has been taken one step further by importing the concept of using "We" [i.e. all the parties] in the legal drafting, and references to matters such as "sharing", "mutual winning position", "avoid disputation and litigation", "agree to work together in successfully executing the work" and "strenuous in their efforts to achieve an ethical, positive, dynamic and results oriented culture".

In alliance projects, the project alliance participants pool their respective resources and capabilities with a view to deriving separate benefits through co-operative deployment of the resource pool. The owner contributes the site, inherent knowledge of the project and money, whilst non-owner participants contribute their skills, experience and resource to carry out the work and, through their joint contribution, the parties aim to deliver the project with outstanding results (or in the case of a lesser standard of performance, sharing of some of the "pain").

These concepts raise the question as to whether in a pure alliance, each alliance participant owes a fiduciary duty to each of the other participants.

A fiduciary must act in the interest of the other party to the relationship and must conduct itself in such a way so that there is no conflict between the fiduciary's interest and the other party's interests. This is to be contrasted with the normal assumption in contractual relationships that each party will be entitled to act in its own interests subject to complying with their *Mackay* v. *Dick*[11] duty of co-operation, and any duty of good faith—see section 4.3, below.

When discussing joint ventures, Mason, Brennan and Deane JJ in *United Dominions Corporation Ltd* v. *Brian Pty Ltd* said[12]:

> "The term 'joint venture' is not a technical one with a settled common law meaning. As a matter of ordinary language, it connotes an association of persons for the purposes of a particular trading, commercial, mining or other financial undertaking or endeavour with a view to mutual profit, with each participant usually (but not necessarily) contributing money, property or skill. Such a joint venture (or, under Scots law, 'adventure') will often be a partnership. The term is, however, apposite to refer to a joint undertaking or activity carried out through a medium other than a partnership: such as a company, a trust, an agency or joint ownership. The borderline between what can properly be described as a 'joint venture' and what should more properly be seen as no more than a simple contractual relationship may on occasion be blurred. Thus, where one party contributes only money or other property, it may sometimes be difficult to determine whether a

[11] (1881) 6 App Cas 251.
[12] (1985) 157 CLR 1 at 10.

> relationship is a joint venture in which both parties are entitled to a share of profits or a simple contract of loan or a lease under which the interest or rent payable to the party providing the money or property is determined by reference to the profits made by the other. One would need a more confined and precise notion of what constitutes a 'joint venture' than that which the term bears as a matter of ordinary language before it could be said by way of general proposition that the relationship between joint venturers is necessarily a fiduciary one: but *cf. per* Cardozo CJ, *Meinhard* v. *Salmon*, 164 NE 545 at 546. The most that can be said is that whether or not the relationship between joint venturers is fiduciary will depend upon the form which the particular joint venture takes and upon the content of the obligations which the parties to it have undertaken."

Courts are generally reluctant to find that fiduciary duties exist in the context of what are in truth commercial dealings. But such a finding may be made where, despite the essentially commercial nature of the relationship, it involves dependence or trust by one party on another.

Where a relationship is such that parties are to act for their common benefit so that neither is at liberty to act in its own interests, it may be one which has fiduciary elements and attracts fiduciary duties. In *Hospital Products Ltd* v. *United States Surgical Corporation* Mason J said[13]:

> "But entitlement to act in one's own interests is not an answer to the existence of a fiduciary relationship, if there be an obligation to act in the interests of another. It is that obligation that is the foundation of the fiduciary relationship, even if it be subject to qualifications including that in some respects the fiduciary is entitled to act by reference to his own interests."

A recent example of a commercial context involving a fiduciary relationship is found in *Aqua Max Pty Ltd* v. *MT Associates Pty Ltd*[14] which concerned what was in reality a joint venture in corporate form. In concluding that a fiduciary relationship existed, Gillard J said[15]:

> "In a recent article, McPherson J considered the question whether there was a simple criterion for identifying fiduciaries. He suggested that a common characteristic is that the fiduciary has conduct, and to that extent some control over the whole or a specific segment of somebody else's affairs. See article "Fiduciaries: Who Are They?" (1998) 72 ALJ 288. I am satisfied in applying that test that MTA and Sietel [the joint venturers] had obligations pursuant to the JVA [joint venture agreement] and consultancy agreement which gave each the required degree of control over one part of the venture, and which meant that each party relied upon the other party to perform its role in good faith and for the common good. This is clear from what each participant brought to the venture. MTA, through J Trihey, brought the ideas and inventions and expert services and Sietel provided the funds. The agreement provided that each party was to use its best endeavours to achieve the objectives of the agreement. Further, any payments of profits through dividends in Aqua Max or royalties and management fees to the respective parties was dependent upon the directors of Aqua Max making honest determinations to that effect, and the original arrangement was that the two directors would be R Rees, representing Seitel and J Trihey, representing MTA."

The characteristics involving contribution by each party of some necessary component, control by each party over a part of the venture, agreement to

[13] (1984) 156 CLR 41 at 99.
[14] 19 June 1998, unreported, Supreme Court of Victoria.
[15] *Ibid.* at 64.

seek common objectives and mutual reliance "in good faith and for the common good" have clear parallels in the relationship among project alliance participants.[16] Accordingly, there are strong grounds for concluding that project alliance participants are in a fiduciary relationship and that each owes a fiduciary duty to the other.

The significance of this conclusion is described as follows in the *Aqua Max* case[17]:

> "I am satisfied that the parties to the JVA each owed to the other fiduciary duties, namely, not to exploit the relationship for its own benefit, not to allow personal interest and duty to conflict and to co-operate in doing all necessary things for the common good of the venture. . . . I have no doubt that each party had to perform its obligations within its domain for the common good of the venture and each party relied upon the other party to carry out the obligations *bona fide* and for the common good. In my opinion, each party reposed confidence and trust in the other and this was appreciated at the outset."

In the "impure" alliance contracts, it is common to find provisions such as:

> "The parties will commit themselves to:
> (a) *working together* towards their common objectives and building on a relationship of trust, openness and fair dealing between them;
> (b) *working together* in a manner to ensure the efficient delivery of the Services by the Contractor in a way acceptable to the Principal so as to achieve mutually satisfactory commercial outcomes."

4.3 Obligations of good faith

In alliance contracts (whether based on the "pure" or "impure" models), there is normally an express obligation on the participants to act in good faith.

An obligation to act in good faith has ramifications for other provisions of an alliance contract; for example, when an alliance participant exercises a right to terminate for convenience under the termination for convenience clause, and the participant's obligation to keep its accounts on an "open-book basis".

Whilst no clear judicial statement on the scope of the term has yet emerged in Australia, the concept of good faith is generally thought to embrace some or all of the following notions:

- an obligation on the parties to co-operate in achieving the contractual objectives;
- a duty to act honestly;
- a duty to recognise and have regard to the legitimate interests of the other party in benefiting from the bargain;
- a duty to comply with standards of conduct which are reasonable having regard to the interests of the parties; and

[16] A feature of "pure" alliances, rather than "impure" alliances.
[17] 19 June 1998, unreported, Supreme Court of Victoria at p. 64.

- an obligation not to act in bad faith.

The duty of good faith is well-established in the United States. Provision is made for the general implication of the duty in both the Uniform Commercial Code ("UCC") and the Restatement (Second) Contracts ("Restatement").

Section 1–203 of the UCC provides a statutory basis for the duty, and states "Every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement". Section 1–201(19) of the UCC defines good faith as "honesty in fact in the conduct or transaction concerned".

Section 205 of the Restatement provides "Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement", and although the Restatement does not have the force of law, it is highly persuasive. The Restatement includes a list of conduct that would be in bad faith, that list comprising "evasion of the spirit of the bargain, lack of diligence and slacking off, wilful rendering of imperfect performance, abuse of power to specify terms, and interference with or failure to cooperate in the other party's performance". According to the Restatement, an exhaustive list of bad faith is impossible to collate, and the content of the duty of good faith depends on the circumstances.

Given these explicit provisions requiring good faith in contracts, the position as to whether the duty is owed is largely settled in the United States. However, despite attempts to define the term, uncertainty still surrounds the nature of the duty to act in good faith and when that duty has been breached. Much appears to turn on the context in which the court is determining whether a party has acted in good faith.

Australian courts have referred to the position in the United States, most notably in *Renard Constructions (ME) Pty Ltd* v. *Minister for Public Works* ("*Renard Constructions*"), where Priestley JA stated[18]: "When the broad similarity of economic and social conditions in Australia and the United States is taken into account the foregoing matters all seem to me to argue strongly for recognition in Australia of the obligation similar to that in the United States."

Similarly, the civil law of continental European countries has an overriding principle of good faith, encompassing fair dealing. However, English courts have been far more apprehensive about embracing such a term.

Article 7(1) of the United Nations Convention on Contracts for the International Sale of Goods ("Convention") provides: "In the interpretation of this Convention, regard is to be had to its international character and to the need to promote uniformity in its application and the observance of good faith in international trade."

Every state and territory legislature in Australia has enacted legislation incorporating the Convention including this provision. Further, the legislation provides that the Convention prevails if there is an inconsistency.

[18] (1992) 26 NSWLR 234 at 268.

The Convention was referred to in *Renard Constructions*, where Priestley JA made reference to the arguments of Steyn J in support of introducing a duty of good faith into English contract law.

The International Institute for the Unification of Private Law introduced the Principles of International Commercial Contracts ("UNIDROIT Principles") in 1994. Australian courts have made reference to those principles when developing arguments for the implication of a term of good faith. Article 1.7 of the UNIDROIT Principles is titled "Good Faith and Fair Dealing", and provides in sub-article (1): "Each party must act in accordance with good faith and fair dealing in international trade."

In *Hughes Aircraft Systems International* v. *Airservices Australia*[19] ("*Hughes Aircraft*"), Finn J referred to the UNIDROIT principles noting they are "fundamental principles to be honoured in international commercial contracts".[20] These comments were considered by Sheller JA in *Alcatel Australia Ltd* v. *Scarcella* ("*Alcatel*").[21]

Despite many references to good faith, Australian courts (like their United States counterparts) have not yet given a clear definition of the duty of good faith.[22]

Good faith and reasonableness

In *Renard Constructions*, Priestley JA observed that, although not synonymous, the duties of good faith and reasonableness and fair dealing will often overlap:

> "there is a close association of ideas between the terms unreasonableness, lack of good faith, and unconscionability. Although they may not always be co-extensive in their connotations, partly as a result of the varying sense in which each expression is used in different contexts, there can be no doubt that in many of their uses there is a great deal of overlap in their content."

In *Aiton* v. *Transfield* ("*Aiton*"), Einstein J stated[23]: "The interrelationship of and difference between good faith and reasonableness is subtle but of great importance. A requirement to satisfy a standard of reasonable behaviour is more demanding than the requirement of good faith . . ."

The Australian cases make no substantial distinction between the terms of reasonableness and good faith. Priestley JA held in *Renard Constructions* that although the two have distinct definitions, practically speaking, there is very little difference. Indeed, in *LMI Australasia Pty Ltd* v. *Baulderstone Hornibrook*

[19] (1997) 146 ALR 1.

[20] *Ibid.* at 37.

[21] (1998) 44 NSW 349 at 365.

[22] The concept of good faith is invariably included in alliance contracts. It is useful to note that the current position (at least in New South Wales and Victoria) is that a duty of good faith will be implied in all commercial contracts—see *Royal Botanic Gardens and Domain Trust* v. *South Sydney City Council* (2002) 186 ALR 289, *Service Station Association Ltd* v. *Berg Bennet & Associates Pty Ltd* (1993) 117 ALR 393, *Cathedral Place Pty Ltd* v. *Hyatt Australia Ltd* [2003] VSC 385. See also J W Carter and E Peden, "Good Faith in Australian Contract Law", 19 JCL 155.

[23] [1999] NSWSC 996 at [133].

Pty Ltd, Barrett J stated[24]: "The content of such terms, is, in a general sense, that the party bound by them, although free to promote his, her or its own interests, must act fairly and reasonably in all the circumstances."

From this judgment, it is apparent that Barrett J considered that the concept of fair dealing is a component of good faith. However, without further clarification as to what fair dealing encompasses, the concept is not overly useful in assessing what amounts to good faith in any particular circumstances.

The Restatement (Second) Contracts in the United States also adopts the notion of fair dealing. Section 205 provides that "Every contract imposes upon each party a duty of good faith and fair dealing in the trade". This provision has been referred to in several Australian cases, including *Renard Constructions* and *Alcatel*.

A duty of good faith does not require self-sacrificing behaviour; indeed, not endeavouring to promote one's own interests is not consistent with the rationale behind forming a commercial contract. A party to a contract is not precluded from promoting its own legitimate interests by reason of the duty.

Finkelstein J threw some light on the phrase "legitimate interests" in *Garry Rogers Motors (Aust) Pty Ltd* v. *Subaru (Aust) Pty Ltd*[25] saying that "provided the party exercising the power acts reasonably in all the circumstances, the duty to act fairly and in good faith will ordinarily be satisfied". In that case, the court found that the principal was not acting in bad faith by terminating the contract, because the behaviour of the dealer in refusing to adopt the new marketing strategy in full was contrary to the business interests of the principal.

This approach was confirmed in *South Sydney District Rugby League Football Club Ltd* v. *News Ltd*,[26] where it was observed that a party pursuing its own legitimate interests would not breach an implied duty of good faith, provided the rights are exercised reasonably and not in contravention of an express term of the contract.

The duty of good faith also prohibits parties to a contract from acting capriciously, or for an extraneous purpose, concepts associated with the concept of "legitimate interests". There is difficulty in enunciating when conduct is capricious or for an extraneous purpose, however, in *Burger King Corp* v. *Hungry Jack's Pty Ltd*[27] ("*Burger King*"), the court held that withholding financial or operational approval where there was no basis to do so was done for a purpose extraneous to the contract.

[24] (2001) NSWSC 886 at [74].
[25] (1999) ATPR 41–703.
[26] (2000) 177 ALR 611.
[27] [2001] NSWCA 187.

Good faith and termination

The duty of good faith, if only implied, will not override express terms of the contract.[28] Where a party is entitled to terminate a contract in accordance with its terms, the imposition of an obligation to act in good faith should not hinder that party from exercising that right.[29]

In *Apple Communications Ltd* v. *Optus Mobile Pty Ltd*[30] ("*Apple*"), the contract contained a termination for convenience clause which entitled Optus to terminate the contract for "any reason". Apple argued that Optus breached its implied duty of good faith by terminating the contract. Windeyer J held that termination of the contract under a termination for convenience clause was not capricious or for an extraneous purpose even though the reason for termination was unrelated to the performance of the distributor, and was exercised to allow the principal to embark upon a new distribution strategy.

The termination for convenience allowed termination of the contract for reasons totally unconnected with the performance of the other party (and even if the performance of the other party was commendable). In light of the express termination clause, termination for those reasons did not breach a duty of good faith.[31]

Bad faith

Certain types of behaviour have been identified as a breach of good faith in accordance with the "excluder" definition of good faith (under which good faith is defined in terms of conduct that is in bad faith). The Canadian judiciary has accepted this approach, observing that "good faith cannot be defined except by providing modern examples of bad faith behaviour".[32]

In *Overlook*,[33] Barrett J also supported interpreting the obligation of good faith by the absence of bad faith.

In *Aiton*, although this approach was held to be of assistance, it did not provide adequate content to fully define good faith. Einstein J held that good faith should not be defined narrowly, and that it should be left to the trial judge to decide what constituted good faith in all the circumstances. Although this approach is uncertain, it gives a flexible approach to defining good faith, and given the circumstances in which the duty has been implied, it seems that that approach has to some extent already been adopted by the courts.

However, judicial discretion should be tempered by the factors mentioned

[28] See for example *Alcatel* (1998) 44 NSW 349 at 368, *Burger King* [2001] NSWCA 187 at [175], whereby Sheller JA considered *Metropolitan Life Insurance Co* v. *RJR Nabisco Inc* (1989) 716 F Supp 1504.

[29] J W Carter and E Peden, *op. cit.* n. 22 at 170–171.

[30] [2001] NSWSC 635.

[31] *Garry Rogers* (1999) ATPR 41–703 at [17–19].

[32] *Gateway Realty Ltd* v. *Arton Holdings Ltd (No 3)* (1991) 106 NSR (2d) 180 at 197, affirmed (1992) 112 NSR (2d) 180, cited in *Aiton* [1999] NSWSC 996 at [113].

[33] *Overlook* v. *Foxtel* [2002] NSWSC 17.

above—these provide a structure within which to determine what will amount to good faith, or breach of good faith, in the circumstances.

Good faith and "open-book" accounting

In *Placer (Granny Smith) Pty Ltd* v. *Thiess Contractors Pty Ltd*[34] ("*Placer (Granny Smith)*"), the High Court awarded substantial damages to a mine operator which had been overcharged by a contractor engaged to carry out mining operations.

The parties had entered into a partnering contract under which the mine manager would pay the cost of mining operations on an "open-book" basis plus a margin of 5%. The parties were also expressly obliged to act in good faith in all matters relating to the calculation of operating costs. The partnering contract was terminated by the mine manager after three years and the contractor claimed damages for breach of contract. The mine manager claimed repayment of the moneys paid to the contractor on the basis that the contractor, in breach of its obligation to act in good faith, had deliberately overstated its costs. The trial judge awarded substantial damages to the mine manager on the basis that the contractor admitted that its claim to the mine manager exceeded the contractor's *bona fide* estimate of costs.

The Full Court of the Supreme Court overturned the trial judge's decision holding that the calculation of damages was flawed and that the operator mine manager had not proved its damages. The High Court reinstated the trial judge's decision.

Callinan, J held that because the contractor had deceived the mine operator as to its true costs, a court should not be too critical of imperfections in the proof of the operator's claim after it had been repeatedly deceived. The contractor's defence of the claim amounted to a deliberate and prolonged process of obfuscation; and this allowed the trial judge more flexibility in calculating damages than that proposed by the contractor. The parties' contractual obligation to act in good faith in all matters relating to their arrangements was not discharged on the commencement of proceedings or suspended during them.[35]

This case emphasises the need for the parties in an alliancing arrangement to strictly comply with their obligations to act in good faith and genuinely keep their books open for review by the other party (including after termination and during proceedings).

[34] (2003) 196 ALR 257.
[35] *Ibid.* at 281.

4.4 Wilful default

Alliance contracts used in the pure alliance model inevitably contain a clause stating that a project alliance participant is not liable to the other participants except in the case of wilful default.[36]

The following provisions are taken from an actual alliancing contract:

> "A failure by any Project Alliance Participant to perform any obligation or to discharge any duty or in connection with this Project Alliance Agreement will not give rise to any enforceable obligation at law or in equity except to the extent that the failure also constitutes a Wilful Default.
>
> 'Wilful Default' is defined as 'in relation to a Project Alliance Participant such *wanton* or *reckless* act or omission as amounts to *a wilful and utter disregard* for the *harmful* and *avoidable* consequences of the act or omission, but does not otherwise include any error of judgment, mistake, act or omission, whether negligent or not, made in good faith by that Project Alliance Participant or by any director, officer, employee, agent or subcontractor of that Project Alliance Participant'."

Wilful default is not confined to a breach of contract or other legal wrong. In the above example, a wilful default occurs if it satisfies three elements:

- it is wanton or reckless;
- it has consequences which are harmful and avoidable; and
- it amounts to a wilful and utter disregard for those consequences.

The concept of wilful default has the following functions in an alliance contract:

(a) it distinguishes between defaults which have legally enforceable consequences for the defaulter and those which do not; and
(b) it expresses the intention that an alliance participant should only be liable to the other participants if it engages in some form of "deliberate" conduct and not for mere negligence.

A further consideration is whether the exemption clause is consistent with the tenets of fiduciary duty that each alliance participant arguably owes to the other alliance participants.[37] The existence of a fiduciary relationship will impose on the alliance participants duties which are more onerous that those specified by contract.

It would also usually be the case that the alliance contract will provide that an event of wilful default by a project alliance participant will enable the other participants to terminate the alliance contract or remove the defaulting participant from the project alliance.

Another consideration is whether the wilful default concept can be argued as an ouster of the court's jurisdiction as it precludes the parties litigating the

[36] One also finds the concept of "wilful default" in trustee liability exclusion clauses. A trustee has been traditionally in default of its duties where the trustee commits, and intends to commit, a breach of the trustee's duty, or is recklessly careless in the sense of not caring whether the trustee's act or omission gives rise to a breach of contract.

[37] See discussion on fiduciary duties in section 4.2, above.

matter for a breach of contract or other legal wrong associated with the project. A contract which purports to oust the jurisdiction of the courts is probably not illegal but is contrary to public policy and therefore void or unenforceable. This is discussed in further detail in section 4.7, below.

4.5 Liability and insurance issues in project alliances

As indicated above, pure project alliance contracts normally provide that an alliance participant will not be liable for any breach of contract or negligence except in the case of a wilful default.

The contract would normally provide that if a project alliance participant is professionally negligent in performing its obligations under the alliance contract and this results in additional work, the project alliance participants will work together to carry out any remedial action and the resulting additional costs would be an alliance cost. There would be no liability on the negligent project alliance participant, other than as reflected in poor performance against the project's agreed key performance indicators.[38]

A conventional professional indemnity policy only responds where the insured has incurred a liability to another party in connection with its negligence. Accordingly, in the above situation, the professional indemnity policy (either of the alliance or the negligent participant) will not respond. This is an important consideration when structuring the alliance and the alliance contract.

In addition, whereas professional indemnity policies are normally required to be maintained until six years or longer after the completion of a project, in the current insurance market it is becoming increasingly difficult to get run-offs of longer than one to three years (to cover claims within limitation periods to take an action against a defaulting party).

We have been informed that insurers currently in the insurance marketplace will not issue the "first party" policies—the policies that cover the "gap" between traditional professional indemnity insurance (which sees the insurer indemnify the insured for a breach of professional duty of care it owes to third parties) and the no-blame culture inherent in a "true" project alliance (which provides for no enforceable obligations under the alliance contract, absent "wilful default"). Such policies have previously been effected in connection with alliance contracts in Australia and New Zealand.

In addition, even if it is possible to effect "gap" professional indemnity insurance for alliance contracts, the cost of effecting and maintaining project specific professional indemnity policies has become prohibitively expensive. Further, even if the insurance is in place, the excess for the professional

[38] In the Wandoo project, consistent with the "no blame" approach, there is limited scope for claims against the alliance project participants except in the case where an alliance project participant attempts to leave the alliance in which case the limitation of the liability of that alliance project participant no longer applies.

indemnity insurance will be an overall alliance cost and not the responsibility of the negligent participant. This raises commercial issues for the project alliance participants as to how they structure their remuneration, liability and risk management model.

Even if there is a professional indemnity insurance structure in place, the negligent project alliance participant will not be responsible for the excess for the professional indemnity insurance which will go towards the overall alliance cost.

Similar considerations need to be taken into account when effecting public liability policies for an alliance. If an alliance has effected a project-specific public liability policy which includes waiver of the insurer's rights of subrogation in respect of the named insureds, and the insurer agrees to cover liabilities assumed under that alliance contract, then the policy will probably respond. However, if each project alliance participant effects its own public liability policy, or if the project-specific public liability policy is not in the terms described above, then the cost of a claim made under an individual policy may be an alliance cost.

4.6 Force majeure

Force majeure is not a common law concept—it is a technique by which the parties seek to contractually delay the application of the common law doctrine of frustration. A contract is frustrated if its performance is rendered wholly impossible, or becomes essentially and fundamentally different from that contemplated by the contract, as a result of circumstances which are not within the control of any party and which are not foreseen by the parties when they signed the contract. Frustration discharges the parties' future obligations to perform a contract. A *force majeure* clause does not necessarily prevent the operation of the doctrine of frustration, but may be relevant to a court's consideration of whether the event has been foreseen by the parties, and may affect the outcome of apportionment of loss or gain if an event of frustration occurs.

The underlying principle of *force majeure* is that the events must be outside the control of the parties to the contract.

A *force majeure* clause in a contract is an express representation of the way in which risk is to be allocated should a *force majeure* event occur. It is useful to identify relevant risks, apportion potential liability and identify alternative ways to mitigate these risks.

Force majeure clauses operate to excuse a party from its obligation to perform if (but only for the duration) a *force majeure* event occurs. If a *force majeure* clause applies, it may extend the time for a party to perform, provide an excuse for a failure to perform or suspend or discharge the performance of a contract. A right to terminate the contract may arise if the *force majeure* event continues for a period of time.

Force majeure clauses are common in long-term construction contracts, infrastructure project agreements, joint venture agreements, management agreements and contracts with international aspects (i.e. supply of goods by sea or air) or which require regular performance of services or goods to be delivered over extended periods.

Statutory provisions may also override the effect of *force majeure* clauses. These provisions may be particularly relevant and should be considered in contracts with government departments or authorities.[39]

4.7 "No dispute" regime

Pure alliance contracts used to date in Australia have normally contained a clause similar to the following:

> "The Project Alliance Participants embrace the fact that one of the prime advantages of alliancing is to avoid disputation and litigation.
>
> The contractual structure is designed to reinforce the fact that there are to be no disputes or litigation, the only exception being in the event of Wilful Default by a Project Alliance Participant.
>
> To that end, a failure by any Project Alliance Participant to perform any obligation or to discharge any duty or in connection with this Project Alliance Agreement will not give rise to any enforceable obligation at law or in equity except to the extent that the failure also constitutes a Wilful Default."

The intention behind this type of clause is, clearly enough, to preclude litigation in case of breach of contract or other legal wrong by a participant which does not come within the wilful default definition.

It is therefore necessary to consider the rule stated as follows by Rich, Dixon, Evatt and McTiernan JJ in *Dobbs* v. *National Bank of Australasia Ltd*[40]: "It is not possible for a contract to create rights and at the same time to deny to the other party in whom they vest the right to invoke the jurisdiction of the courts to enforce them."

Jordan CJ stated the principle thus in *Murphy* v. *Benson*[41]: "A provision that an existing legal right shall not be determinable or enforceable by the appropriate Court is void for repugnancy to the right."

A distinction is drawn in this area between what Crompton J described in *Scott* v. *Avery*[42] as "a case where there was a complete cause of action which the agreement forbade the party to sue upon" and a case where "the parties have agreed . . . to make the right to payment contingent upon" some precondition—in other words, to qualify and cut down the right by reference

[39] E.g. see ss.313, 323 and 335 of the Telecommunications Act 1997 (Cth) and the essential services legislation applicable to each relevant jurisdiction.

[40] (1935) 53 CLR 643 at 652.

[41] (1942) 42 SR(NSW) 66 at 67.

[42] (1855) 5 HLC 811at 833.

to the precondition. A qualification which affects the definition and content of an obligation is thus different from one which seeks to prevent enforcement of an unqualified obligation.

Under this type of the no disputation clause, a failure to perform any obligation or to discharge any duty arising out of or in connection with the Project Alliance Agreement "will not give rise to any enforceable obligation at law or in equity" unless it amounts to wilful default.

This clause states a rule which applies where a particular failure to perform an obligation or to discharge a duty does not constitute wilful default, that is, that the failure to perform the obligation or to discharge the duty will not give rise to any enforceable obligation at law or in equity.

This provision, that failure to perform an obligation or to discharge a duty "will not give rise to an enforceable obligation", logically cannot be a statement about the nature or content of the obligation or duty. Rather, it is, in reality, arguably, an undertaking by each party not to sue any other party for breach of contract, or upon some other available cause of action arising out of the parties' legal relationship, unless the default on which the suit is based is within the wilful default definition.

Viewed in this way (and in the light of its statement that "there are to be no disputes or litigation, the only exception being in the event of wilful default by a project alliance participant"), this type of the no disputation clause is arguably void in so far as it purports to preclude litigation in relation to breaches which do not constitute wilful default.

If this is so, failure to perform an obligation or to discharge a duty can be litigated at the suit of the wronged party even where "wilful default" is not involved. There is, therefore, a real question whether a no disputation clause in this frequently encountered form is legally effective to implement the alliance participants' undoubted (at least at the commencement of their alliance!) commercial intentions.

The position would be different if, rather than forbidding litigation in relation to all defaults other than those constituting wilful default, the contract made it clear that there was no breach except for wilful default. The problem with this is that it may be impossible, in any practical sense, to frame a substantive obligation which incorporates this qualification and, at the same time, remains meaningful. A promise to execute works only in such a way and only to such a standard as is consistent with absence of wanton or reckless disregard by the contractor for harmful and avoidable consequences is unlikely to be satisfactory from the principal's viewpoint.

An alternative drafting approach to the issue that may overcome the problems canvassed above would be to avoid reference to "no litigation", and the risk of a legally ineffective ouster of the court's jurisdiction, and simply exclude all liability (via a well drafted exclusion clause) for breaches not involving wilful default (other than such monetary disbenefit as the defaulting party may suffer through application of the alliance contract's KPI/gainshare arrangements).

4.8 Termination for convenience

Termination for convenience clauses are commonly found in alliance contracts.

A termination for convenience clause allows a party to terminate at its discretion and is not limited to any circumstance (e.g. whether or not there is a breach of the contract by the other party). The clause invariably includes a compensation regime under which the contractor is paid up to the point of termination for work carried out, but does not normally include loss of anticipated profits.

This type of clause has not been the subject of extensive discussion in Australian cases. The most recent cases are *Placer (Granny Smith) Pty Ltd* v. *Thiess Contractors Pty Ltd*,[43] which went on appeal to the High Court, and the *Apple* case.[44]

In Hudson's *Building and Engineering Contracts*, 11th ed. at Chapter 12, the following statements are made:

> "Convenience clauses as they are generally known in the United States are owners' determination clauses expressly *not* conditioned on any breach or event or default for which the contractor could be regarded as legally responsible, but exercisable simply at the discretion of the owner. In United States Government contracts, where they have been continuously in existence since the Civil War, (*US* v. *Corliss Stream Engineering Corporation*, 91 US 321 (1876) and see the history examined in *Troncello* [*sic*] v. *US*, 681 F 2d 756, 764–6 (Ct Cl 1982)), some such wording as 'for the convenience of the Government' or 'in the best interest of government' has often been used, but no special importance attaches to this, and in principle it is sufficient if the wording of the contract simply distinguishes the right of termination from one based on contactor default or responsibility. Typically, the clauses co-exist in the same contract as a separate default termination clause, and at the present day the United States courts will not be slow to fasten on and implement any wording of the contract suggesting a requirement of election by the owner between the two remedies (*Rogerson Aircraft Corporation* v. *Fairchild Industries*, 632 F Supp 1494 (1986)). The practical effect and purpose of the clauses is that they usually permit recovery of contract or reasonable value, plus a reasonable profit *on the work done prior to the termination*, as well as settlement of sub-contractor accounts and any removal or other expenses, but disallow any claim for loss of profit on the remaining work. Nor do they, of course, confer any of the special ancillary rights on the owner to be found in default termination clauses . . .[45]
>
> Where the motive for an expressly invoked convenience termination was to secure a more attractive price elsewhere, a decision in 1974 which had upheld such a termination and rejected a loss of profit claim by the contractor was disapproved in a further seminal Court of Claims case in 1982 (*Troncello* [*sic*] v. *US*, 681 F 2d 756 (1982)), disapproving *Colonial Metals* v. *US*, 494 F 2d 1353 (1974). . . .[46]
>
> However outside the United States, there appears to be little or no authority on [this] point[s], though 'convenience' determination clauses undoubtedly do exist in some public or private contracts in England and the Commonwealth. It is probably preferable to approach the . . . area[s] of dispute referred to above in terms of first principles, it is submitted, rather than by too close an adherence to the Court of Claims cases, where an

[43] [2000] WASCA 102.
[44] See discussion on that case in section 4.3.
[45] Para. 12–014.
[46] Para. 12–015.

element of administrative policy and practice rather than strictly consensual theories has often underlined many Court of Claims doctrines. . . .[47]

In terms of first principles, a convenience clause may be regarded, it is suggested, as primarily designed, in the absence of express indication to the contrary, to give the owner the commercial freedom to abandon the project, or a part of it, either permanently or temporarily at any time. It may also be regarded, it is again suggested, as intended to afford an owner who is dissatisfied with a contractor's progress or work with an alternative and less controversial remedy than that available under an accompanying default-based termination clause, thus avoiding the expense and risks of a contested default determination while sacrificing some of its financial and procedural advantages. . . .

On this view, it is submitted, on the analogy of the authoritative Commonwealth and later English cases similarly restricting the power to order omissions by way of variation, that it will be a breach of contract for an owner to exercise the remedy, in the absence of sufficiently express wording, if his purpose in doing so is to obtain the more attractive prices of another contractor to complete the work (see *Carr* v. *J A Berriman Pty Ltd* (1953) 27 ALJ 273 High Court of Australia and the cases illustrated ante, Chap 7, Section 2(2), paras 7–043 *et seq.*). In such a case incidentally, there seems to be no reason why knowledge of the alternative source or price on the part of the owner at the time of contracting should be a necessary ingredient or of any relevance in establishing his breach, which depends on placing a reasonable as opposed to an exploitative interpretation on the variation power. . . .

If this view of convenience clauses is correct, and the owner exercises the power because he has decided to abandon the project either permanently or for the time being, or because he is *bona fide* dissatisfied with the contractor's performance but prefers to avoid a default-based confrontation, there will be a legitimate exercise of the power, it is submitted. On the other hand, where the owner has repudiated the contract by some other breach, so that the contractor is entitled to and does rescind at common law, or where the owner has unsuccessfully sought to determine the contract at common law or under a default provision in order to obtain the remedies and damages available against the contractor in such a situation, it will follow that a ruling which deprives the contractor of loss or profit or other consequential loss in that event will mean that the convenience clause has in effect been interpreted as a partial 'no damage' or exclusionary clause, operating automatically in all situations, and whether or not in fact invoked at the time by the owner." [48]

Seddon in his text *Government Contracts* states that

"it is arguable that a termination for convenience clause renders the contract void on the basis that the 'contract' is effectively optional, as far as the government is concerned. The government, according to this argument, promises nothing and thus there is no consideration provided by the government. It is analogous to the case where an exemption clause is so sweeping that it destroys the consideration."[49]

This is generally addressed by executing the contract in the form of a deed and including a compensation regime that applies when exercising that termination right.

[47] Para. 12–016.
[48] Para. 12.017.
[49] At p. 127, section 5.5.

4.9 Occupational health and safety and environmental obligations

There are numerous legal responsibilities which an owner of land has at common law or under statute. Those legal responsibilities need to be taken into account by the owner alliance participant notwithstanding that it has entered into an alliance.

Occupational health and safety obligations

Responsibilities that may apply to an owner of land in respect of construction or operations carried out on that land include[50]:

(a) its duty as an employer to ensure the health, safety and welfare at work of all of its employees;
(b) its duty to ensure that people other than its employees are not exposed to health or safety risks arising from the conduct of its undertaking while they are on the land;
(c) as a "*controller of premises*" used as a place of work, or of plant or substance used at work, the owner must ensure that the land, and the plant or substances, are safe and without risks to health when properly used (including providing adequate information to the user).

In some jurisdictions, an owner of land who engages contractors to carry out work on the land is obliged under statutes to appoint a "principal contractor" to be responsible for the occupational, health and safety measures for workers carrying out the construction work.[51] An owner who does not make that appointment must itself implement those occupational, health and safety measures.

In an alliance contract, depending on whether it is a two party or multi-party alliance, the owner of the land will need to consider carefully who is the best party to manage those occupational, health and safety issues. In the case of a multi-party alliance, then the most appropriate alliance participant should be appointed the principal contractor.

The various statutes prescribe what an employer or other controller of a place of work or principal contractor is required to do only in very general terms, except in the case of certain inherently risky activities. Generally, employers, controllers of places of work and principal contractors are required to identify hazards, assess the risks arising from those hazards and eliminate or (where this is not reasonably practicable) control those risks.

In an alliance, it is important that these obligations and requirements are satisfied. Whilst the project alliance participants are generally obliged to comply with occupational, health and safety requirements in the alliance contract, the owner alliance participant must ensure that its obligations are

[50] See Occupational Health and Safety Act 2000 (NSW) and accompanying Occupational Health and Safety Regulation 2001 (NSW); Workplace Health and Safety Act 1995 (Qld).
[51] See Chap 8, cl. 210 of the Occupational Health and Safety Regulation 2001 (NSW).

complied with either by appointing an appropriate project alliance participant as the principal contractor or by appointing a controller of premises.

Environmental obligations

Australia has comprehensive and detailed environmental laws.

In addition to companies being liable for environmental offences, directors of those companies also can be personally liable. There are several defences available to companies (and their directors). In most jurisdictions, companies (and their directors) usually rely upon the due diligence defence. To do so, a company must ensure that environmental risks arising from the company's operations (or, in the case of projects, the construction activities) are being identified, assessed and managed.

Whilst the project alliance participants will be obliged to comply with their environmental-related obligations under the alliance contract, it is important for the owner alliance participant to ensure that there is continuous monitoring and management of the environmental issues arising from the companies' operations or the construction of the project.

Performance measures in alliance contracts often involve linking non-cost related aspects of objective performance with the KPI/gainshare arrangements—this may require targets for the alliance to meet or exceed environmental targets and to ensure that there is no breach of environmental laws when carrying out the project in order to earn a higher than normal fee.

4.10 Ownership/licensing of intellectual property rights

Technology and intellectual property rights ("IP") are invariably important elements of alliance projects. The parties may bring valuable IP to the alliance, or develop it during the course of the project, or both. In all alliances models it is important to make it clear who owns the IP rights and what rights the other parties have to use those rights both inside and outside the alliance.

It is usually agreed that each party to an alliance retains ownership of all IP it brings to the project. This is especially important for parties who wish to retain the competitive edge their IP offers for future engagements. The pre-existing or "background" IP is normally licensed to the other alliance participants only to the extent necessary to undertake, and for the purposes of, the project.

While this approach may seem more in keeping with a traditional contracting model, the parties are free to be innovative in terms of drafting the scope of the licensing arrangements. If an owner/operator requires the IP of another party to operate plant, ownership of the IP need not be transferred to the operator if it is able to negotiate a broad enough licence for the IP. This may be repugnant to the operator who is paying vast sums of

money for another alliancing member to construct the dam. However, if the licence is cast broadly enough, the operator's needs can be met and both parties' interests protected.

Normally, it is agreed that any modification or enhancement to background IP reverts to the original owner, as it will often be the only party able to exploit the modification or enhancement (unless it can be used as a stand alone product). Commonly the modification or enhancement will be embedded in or will rely on the original work and it would be impractical for different parties to own "bits" of the IP in the enhanced product.

New IP developed during the project is often the most difficult to address. In an alliancing arrangement it is tempting to specify that new IP is to be owned jointly by the parties. Although this may seem a neat solution during negotiations and appears in keeping with a "pure alliancing" model, joint IP ownership often gives rise to practical difficulties. For example, a potential invention relating to turbine technology may be jointly developed based on enhancements to existing technology. If the parties jointly own the IP in this enhancement, a number of questions will need to be worked through by the parties. For example:

(a) should the invention be protected by filing patent applications? This can be an expensive exercise and one alliance participant may not be interested in exploiting the technology given the cost of doing so and the uncertainty of whether patents will be granted and, if they are granted, whether they will lead to significant royalties; or
(b) can they both use the invention outside the scope of the current project? If it is based on an enhancement to existing technology, this is likely to depend on whether the owner of the existing technology agrees. In the end, that party may not agree to that use and the other party may have wasted time and money negotiating joint ownership of something that it cannot exploit.

If the parties do wish to have joint ownership of newly developed IP, these issues can, of course, be dealt with in the alliance contract. Alternatively, the parties may choose to leave them to be resolved outside the bounds of the contract on the basis that the parties will work together in the best interests of the alliance.

From a practical perspective it may be better to have IP ownership resting with the party most likely to exploit the technology with the proviso that the other alliance members share in any royalties (although it may be prudent to consider the common law and transaction implications such provisions may have for the characterisation of the alliance as a joint venture or partnership). The owner of the IP may also separately license the IP to the other alliance participants for future use outside the project.

If the parties are not in a position to agree the terms of royalty payments upfront, then they could agree to vest the newly developed IP in the name of one party but restrict all parties from using it outside the project without the

consent of all other parties. This would provide a "roadblock" mechanism for getting the parties together at a future date to discuss, negotiate and resolve these issues because, without that agreement, no party will be able to use the IP outside the project.

From the above, it can be seen that whilst the joint IP ownership may on its face seem more in keeping with an alliancing approach, IP rights can be licensed in a such a way as to ensure that each alliance participant gains the benefit of the alliance's joint efforts.

4.11 Trade Practices Act implications and misrepresentation

It is a common mistake to assume that all the parties' legal rights are found in the express terms of the alliance contract. Negotiations and documents which are not part of the alliance contract may attract other legal rights, for example, under the Trade Practices Act and the Fair Trading Acts in each state and territory.

Section 52 of the Trade Practices Act 1974 (Commonwealth) (TP Act) prohibits misleading and deceptive conduct. If a party acts to its detriment in reliance upon assurances, undertakings, representations or conduct of another party in relation to a contract, which were in the circumstances misleading or deceptive, then it may be able to take action under section 52. Silence may also constitute misleading or deceptive conduct where there is a duty to reveal relevant facts.

A proven breach of section 52 gives rise to a remedy under either section 82 or section 87 of the TP Act. Damages for a breach of section 52 of the TP Act are awarded so as to restore the plaintiff to the same position which would have existed had the breach not been committed. Intent is not a requirement for a contravention of section 52 and the section may be contravened notwithstanding that the person making the representation is innocent or has acted reasonably.

Section 51A of the Act enlarges on section 52, providing that, where a representation is made with respect to any future matter (including the doing of, or the refusing to do, any act) and there are no reasonable grounds for making the representation, the representation will be taken to be misleading. In an action under section 51A, a party who makes a representation as to any future matter, is deemed not to have had reasonable grounds for making the representation unless it adduces evidence to the contrary.

Each state has its equivalent of sections 51A and 52 of the TP Act.[52]

In addition, it is also possible to bring an action for the tort of negligent misstatement. For an action to be based on this ground, it will generally be

[52] Ss.41 and 42 of the Fair Trading Act (NSW), ss.37 and 38 of the Fair Trading Act (Qld), ss.54 and 56 of the Fair Trading Act (SA), s.14 of the Fair Trading Act (Tas), ss. 10A and 11 of the Fair Trading Act (Vic), ss.9 and 10 of the Fair Trading Act (WA), ss. 41 and 42 of the Consumer Affairs and Fair Trading Act (NT), ss.11 and 12 of the Fair Trading Act (ACT).

necessary for the false statement or misrepresentation to have caused some loss, or to have caused an undesirable state of affairs which the plaintiff requires to be remedied. In most cases, parties tend to rely on their rights under section 51A and 52 of the TP Act if there has been a misrepresentation.

4.12 Estoppel and waiver

The conduct of the parties to a contract (including representations made orally or in writing) may give rise to an action based on estoppel or waiver. These issues can also alter the parties' overall legal (as opposed to simply contractual) relationship.

Broadly speaking, estoppel is an equitable principle which prevents a party, who by words or conduct leads another party to assume a particular state of affairs, from later acting contrary to that assumption. For an action to succeed on this basis, it is necessary to show some words or conduct on the part of the first party on which the second party acted (or refrained from acting). It is also necessary to establish that it would be unconscionable to allow the first party to depart from the words or conduct.

The concept of waiver (in the sense of estoppel) of a right may include, or result in, not only the giving up of a right, but also conduct which makes it unfair, inequitable or unconscionable for the relevant party to insist on the right, the inability to assert a substantive right a party would otherwise have, or an inability to raise a particular defence which would otherwise be available.

It is important that each project alliance participant, when negotiating the contract and conducting the pre-contract alliance workshops, is clear in what it represents and promises (through conduct or words) to the other project alliance participants as to relevant matters, including its future conduct and behaviour.

All of the above applies irrespective of even the most comprehensively drafted entire agreement or exclusion clauses. The courts have decided time and again that it is not possible to contract out of statutorily imposed standards of fair conduct (such as section 52 of the TP Act).

4.13 Special public sector considerations

Public sector agencies are generally required to follow rigorous government policies and procedures for procurement of works and services and contracting out. There is an increased focus on probity to ensure efficiency and effectiveness in the contracting process. Salient factors that government bodies consider as part of the probity process include:

- value for money;
- transparency of process;
- dealing with conflicts of interest;
- accountability; and

- monitoring and evaluating performance.

The concept of value for money has been discussed in greater detail in section 2.7, above.

In more recent times, governments at both Commonwealth and State levels have increasingly used or encouraged the use of alliancing to deliver major complex projects.[53,54,55] Audits of major projects such as the construction of the National Museum of Australia and the Northside Storage Tunnel project have endorsed those projects as satisfying the value for money provisions of the relevant governments' procurement guidelines.[56]

5. WHERE TO FROM HERE?

5.1 Is alliancing appropriate for all projects?

The following has been taken from various industry sources:

> "It took a lot of effort to get the management of the four companies in our alliance to think the same way. . . . It sounds simple and everybody thought it was a good idea, but there is a considerable amount of management time and effort required to make an alliance work. If you don't commit the time, it doesn't work. If you do commit the time, it is still hard work." Robert Jones, Woodman Point Project.[57]

> "Alliancing is not the next saviour of the world. . . . The challenge for the industry in the new millennium is how we take the behaviours that make alliances work—things like trust, commitment and respect—and get them back into our more traditional delivery strategies." Jim Barrett of the Australian Constructors Association.[58]

In an article on a prominent project in Australia, it was stated that "one of the critical issues uncovered is that contract alliances work well when progress is good. However, when a contract falls behind and any bonuses (or penalties) have been used up, the incentive for a contractor to perform at optimum pace is lost."[59]

[53] The Commonwealth Government has entered into the Project Djimindi alliance for the delivery of the anti-submarine warfare lightweight torpedo project and the ANZAC ship master alliance whose objectives range from the maintenance of the design integrity of the ANZAC class ships to ensuring work is allocated on a "best for project" and "value for money" basis (see Defence Materiel Organisation website *www.defence.gov.au/dmo/lsd/alliance/alliance.cfm*) , the NSW Government (via Sydney Water Corporation) on various alliances for the Northside Storage Tunnel and the priority sewerage projects in the northern suburbs of Sydney, the Queensland Government (through the Main Roads Department and Gladstone Water Services) for various road projects and the Awonga Dam project, and the Western Australian Government (via the Water Corporation of WA) for the Woodman Point WWTP treatment plant.

[54] See Keynote address "The Road Map for the Defence Public Private Partnership" by the Hon Fran Bailey, MP, Parliamentary Secretary to the Minister for Defence at the Defence Summit in February 2003.

[55] The NSW Government Codes of Practice and Implementation Guidelines for the Codes of Practice and Codes of Tendering have generally encouraged co-operative contracting approaches such as partnering and alliancing.

[56] Australia National Audit Office, *Construction of the National Museum of Australia and Australian Institute of Aboriginal and Torres Strait Islander Studies*; NSW Audit Office, *Performance Audit: Sydney Water Corporation: Northside Storage Tunnel Project*, July 2003.

[57] M Cave, "Alliances", *The Australian Financial Review Magazine*, 2000.

[58] *Ibid.*

[59] Treadgold, T, "Woodside blow-out spurs tough remedies", *Business Review Weekly*, 23 March 1998.

These quotes emphasise the importance of putting the right risk profile for a project in place, choosing the right alliance co-participants and having a well-drafted contract which clearly articulates the risk allocation and/or sharing negotiated by the parties and on which the parties can rely as a safety net to protect their prospective rights.

A party to a new alliance relationship should never underestimate the cultural changes likely to be required of it to achieve the more open relationship inherent in an alliance and the transition from a principal/contractor relationship to work as part of a "blended" team.

5.2 Standard form alliance contracts

It is highly inadvisable to use a currently available standard form of general conditions from the construction industry for an alliance contract without substantial amendment (in fact, virtual rewriting).

Over the last few years, the use of alliance contracts has developed to a stage where participants in various industries have become increasingly familiar with the normal elements of the structure of a "pure" alliance type contract and a "strategic" alliance type contract.

Appendix 1 sets out a sample structure for each of those types of alliance contracts.

5.3 Alliancing in project financed deals

Project financiers inevitably undertake a detailed analysis of the risks associated with the project and the financiers try to create, to the maximum extent possible, a closed circuit of risk by allocating all the project risks between identifiable parties and putting a detailed mechanism in place to manage those risks. Inevitably, that involves a transfer of major risks to the contractors in delivering the project.

Alliancing is generally used in those projects where risks are more difficult to quantify and allocate. In alliancing projects, the alliance project participants generally share the risks and rewards in accordance with a pre-agreed structure (rather than being allocated responsibility for specific categories of risks).

This difference in risk management strategies has been one of the major obstacles to the use of alliancing in project financed deals, particularly where there is no "deep pocket" sponsor.

In conventional project financing involving a single project sponsor, the project sponsor would own the project directly or, more likely, hold the project through a special purpose vehicle. Historically, in resources projects, the sponsor has participated directly in the project with recourse limited to the project assets.

However, in infrastructure project financing, the project sponsors generally participate through special purpose vehicles so as to insulate the

project sponsors from liabilities associated with the project. Project financiers are concerned with the use of alliancing for project delivery because of the uncertainty of no guaranteed contract price or completion dates, the lack of standard protections such as liquidated damages and performance undertakings and the lack of a "deep pocket" sponsor, because of the limited recourse nature of project financing deals.

It may be time that project sponsors and project financiers of major projects reconsider their risk management approach towards alliancing projects. It may be that in complex projects with substantial "unknown" risks, the more appropriate form of project delivery structure (such as alliancing) is one that can manage those risks so as to achieve timely and cost-effective delivery targets (rather than transferring risks which will involve paying a risk premium to the contractor for taking those risks, and hence increase project costs) and for a "deep pocket" sponsor to support that delivery strategy. This also adds support to the "value for money" proposition discussed in section 2.7, above.

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APPENDIX 1: SAMPLE STRUCTURE OF PURE AND STRATEGIC ALLIANCE CONTRACTS

I. Sample structure for strategic alliance contract

1 Definitions and interpretation
2 Alliance relationship
Alliance relationship
Board
Alliance Management Team
Integrated Process Teams
Missions statement
3 Term and transition phases
Term
Transition in phase
Transition out
4 The contractor's primary responsibilities
The contractor's primary obligation
The contractor's performance warranties
Access to plants
Interface with plants' operations
Manufacturer's warranties
Compliance with law