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Julian Critchlow considers that the role of the contract in partnering arrangements has been little explored, and the failure to understand the relationship between the contract and partnering arrangement can have devastating consequences.

When George Bush was President of the US, and Dan Quayle was Vice-President, it was said that the most frightening phrase utterable in the free world was "the President is unwell". In the modern construction world, perhaps, an equally devastating phrase is that which constitutes the title to this article, for the role of the contract in partnering arrangements has been little explored, and the failure to understand the relationship between the contract and partnering arrangement can have devastating consequences, recalling the quotation:

"Failure to crystallise an agreement with the other party is akin to putting your head in a guillotine and saying to your partner, the potential executioner, 'put it in the basket - I'll read it later.' (*Construction News*, 5 September 1996)

Desirability of contracts

It is, at this point, pertinent to recall why contracts are desirable. In somewhat simplistic terms, contracts commonly delineate: what each party must do; what each party receives; time for performance; and sometimes, consequences of failure. More fundamentally, contracts decide where risk is to fall.

It is suggested that whatever form of partnering arrangement is entered into, and there are many, the importance of retaining those contractual certainties remains constant.

Thus, where the parties are not from the beginning bound

by enforceable obligations as to the scope and nature of the contract works, it is likely that agreement in the course of the contract as to these issues will be difficult to obtain. However strong the parties' relationship, uncertainty and human nature may combine in a dangerous amalgam so that, as the works progress, and the parties' own circumstances change (for example, in respect of cash-flow and work-flow), resolving quality and timing issues has every possibility of giving rise to disputes. The relationship is thereby subjected to additional tensions which are largely avoidable.

Moreover, external circumstances may nullify the good effects that the partnering agreement has produced. For example, if a party becomes insolvent there are few prospects that its receiver or liquidator will honour non-binding understandings reached before their involvement: rather, they will seek to maximise the available contractual benefits. Therefore, it is plain that entering into a partnering arrangement is in itself no substitute for a binding contract.

A more subtle school of argument understands that contracts are necessary where there is a partnering arrangement, but contends that the contract terms should be diluted. Thus, it is argued that some contract terms are incompatible with a partnering arrangement. Prominent amongst such terms is the obligation on a contractor in delay to pay or allow liquidated damages to the con-

external circumstances

*contracts decide
where risk is to fall*

tractor's employer. It is said that such a term wrongfully penalises the contractor who can be relied upon by virtue of a good partnering relationship with the contractor's employer to do their best to perform timeously without such compulsion; and, in any event, the contractor simply prices for the risk of liquidated damages, thereby unnecessarily inflating the contract price.

Devolution of risk

However, even this modified view fails properly to recognise the true importance of the contract. As noted above, contracts fundamentally concern the devolution of risk. Partnering agreements are not so concerned. Thus, in the absence of the provision of liquidated damages, and assuming common law damages are excluded, the employer assumes the delay risk of ground conditions, weather – indeed all engineering, economic, and political risk that the contract may be subject to.

*employer
assumes risk*

Yet the contractor may be in a better position to reduce, manage, or assume some of such risks and they should, therefore, be devolved on the contractor. There is no obvious reason for partnering arrangements to distort the risk matrix. If a risk which is assumed by the contractor materialises and causes delay, the contractor, in paying or allowing liquidated damages simply compensates the employer for the employer's loss: the contractor is not *penalised* as such. Nothing in that is inconsistent with partnering.

Retention

It is true that certain other common contractual terms are less obviously compatible with partnering arrangements. One such is the employer's deduction of retention. The philos-

ophy of retention is directed largely at securing performance. It is not about the sharing of the project risks; and it is expensive for contractors to have to shoulder. In a project relationship distinguished by trust and co-operation such a stick to compel performance should, in principle, be unnecessary.

However, even in this instance the case for moderating the contractual terms is uncertain. Thus, retention does not merely compel timeous performance; it can also protect the employer from a contractor's insolvency, thereby assuming an importance independent of partnering considerations. Accordingly, rather than dispense with retention in its entirety, an employer who is a party to a partnering relationship may be advised to look to alternative protection such as a retention bond. This emphasises the point that it is important, when considering changes in contract terms in the light of a partnering agreement, to examine all the potential legal consequences of such changes. It is dangerous to try to apply a universal contract strategy where a partnering arrangement is in place.

retention bond

Further again, certain contract terms will be non-excludable as a matter of law. Of particular relevance in the construction context are the provisions of the Housing Grants, Construction and Regeneration Act 1996. Thus, the right to adjudicate at any time is inalienable irrespective of the parties' desire to adopt dispute resolution processes which are more compatible with partnering, for example, mediation.

Interralation between contract and partnering arrangement

The question then arises as to what, if any, interrelation there

*promotion of
partnering objectives*

may be between the contract and the partnering arrangement. It is suggested that this occurs in two ways, and they are reverse sides of the same coin: first, the contract can be devised in such a way as to promote the partnering arrangement, and secondly, the partnering arrangement can assist the efficient running of the contract.

Taking the first of those, the contract terms can be selected or modified (without being diluted in the manner explored above) so as to promote partnering objectives. For example, the contract provisions may be structured so as to encourage a confluence of interests by the use of bonus payments for completion on time or to budget. It appears to be an increasingly common arrangement for the contract to proceed on a cost plus basis with a guaranteed maximum price (GMP). If the project costs exceed the GMP the contractor bears the balance, but if the cost is less than the GMP, the employer and contractor share the balance. Such arrangements can be transported down the contractual chain so as to include major subcontractors.

It might be thought that if the contractor completes for less than the GMP, the GMP was set too low: paying the contractor a bonus for completing for less than the GMP artificially inflates the contractor's profit. However, it is suggested that that view is theoretical rather than realistic. Maximising incentives can promote efficiency and stimulate innovation. The contractor is unlikely to research and implement new working practices that only benefit the employer.

The second way in which the contract and partnering arrangement may interrelate is in the arrangement's faci-

tating of the progress of the contract. This is probably the most familiar way in which partnering is perceived to operate. The quintessential principle of partnering is founded upon the notion that contractual mechanisms are fundamentally adversarial in structure: whatever bonus schemes are imported into the process, ultimately, the more the contractor receives, the more the employer pays.

That opposition of interests is a fertile breeding ground for inefficiency and dispute. Partnering arrangements should not blur the contractual matrix of rights and obligations, but they may reduce the impact of some of the contract structure's least desirable aspects. The methodology of this aspect of partnering is concerned essentially with the relationship of the parties and how to improve it so as to reduce cost, improve efficiency, and increase profit.

Specifics of the process might include, at one end of the scale, simple adherence to a partnering charter setting out how the parties intend to perform the contract, for example, with openness, honesty, and co-operation. At the more sophisticated end of the scale may be the formulation of a detailed framework agreement applicable to projects to be undertaken by the parties jointly over a number of years and providing for such matters as integration of teams, partnering workshops, joint quality assurance systems, and agreed benchmarked measurement for continuous improvement.

However, it is suggested that such arrangements should generally be formulated separately from the contract. They should assist the administration of the contract, but they should not themselves have contractual effect. Indeed, to avoid uncertainty, they should be recited in documentation

partnering charter

which expressly states that they are non-contractual. The reason for this is that such aspects of the parties' relationship are not easy to accommodate unequivocally within a contractual structure. An example is the commonly stated intention of partnering participants to act in good faith.

This is plainly desirable in principle. However, it is extremely difficult to give the concept of good faith a precise meaning, and individual views as to its meaning are likely to differ. It has, for example, a very specific meaning in relation to insurance and partnership law and this meaning is probably far narrower than is generally intended in respect of a partnering arrangement.

Good faith and co-operation

The broad idea of good faith in the partnering context is imported into clause 10 of the Engineering and Construction Contract (ECC) which requires the employer, contractor, project manager and supervisor to act "as stated in this contract and in a spirit of cooperation". Again, on the face of it, it is difficult to dispute the sentiment. However, the wording of the clause could cause severe difficulties in practice. In particular, it may be difficult to relate to the obligations it imports to other more specific provisions of the contract. Thus, the ECC provides by clause 61.3 that if the contractor believes that a compensation event has occurred, the contractor can notify the employer and obtain recompense.

The contract further provides that such notice must be given within two weeks of the compensation event's occurrence. Suppose the contractor gives the notice eight weeks

after the occurrence. Is the employer entitled to say that the notice has been given out of time and the entitlement to compensation is lost (subject to arguments as to whether time is of the essence for this notice period)? Or is the employer obliged to extend the contractor's time for serving the notice as a function of the employer's obligation to "co-operate"? If it is not a function of the obligation to co-operate, to what does that obligation extend? If it is such a function and the employer is obliged to grant an extension, the entire edifice of contractual obligations becomes unsteady as each obligation must be read subject to the co-operation requirement. If the parties' relationship breaks down, resolving such issues in the courts or by arbitration is likely to be an expensive and uncertain process.

an expensive and uncertain process

Accordingly, it is suggested that those aspects of partnering that concern the manner in which the parties intend to conduct their relationship are most appropriately reserved to a separate document expressed to contain the parties' moral commitment, but not giving rise to binding legal obligations.

Conclusion

The relationship between a partnering arrangement and the underlying contractual obligations of the parties has the potential to be complex. Whilst the contract terms can be sculptured to assist partnering objectives, and whilst the essence of the partnering arrangement is to facilitate the efficient conduct of the contract, it is desirable to keep general expressions of intent concerning the parties' relationship distinct from the specific contract terms.

difficulties in practice