Megaprojects and Alliance Agreements

By Doug A. Graham

Canada, particularly Western Canada, has recently experienced an explosion of megaprojects. These projects can be seen in the oil and gas industry, ranging from oil sands plants and upgraders to liquefied natural gas facilities.

Megaprojects have the following characteristics:

- A cost of at least $1 billion;
- Significant construction complexity involving long and complex supply chains for labour, materials and components;
- Various component sub-projects, each of which is very large;
- Involvement of a project management team, which is responsible for coordinating and controlling the various engineering, procurement and construction management (EPCM) subcontractors and holding them accountable; and
- Involvement of a number of sophisticated EPCM subcontractors who are responsible for the large component subprojects.

Megaprojects can have a complexity and degree of difficulty which approaches that of a military operation. But unlike military operations, megaprojects are held together by mutual self-interest and the legal system or, sometimes, legal systems since the supply lines for such projects usually cross the boundaries of many legal jurisdictions.

Because of the difficulties inherent in enforcing accountability on a megaproject, various legal structures have been tried with varying degrees of success.

One legal structure used is the alliance agreement, usually written to provide overall guidance to the major megaproject participants. It is the head or master agreement that governs all sub-agreements.

Alliance Agreements

Alliance agreements have their origin in the desire of the owner and contractors to minimize disputes on a project. By putting participants into a legal framework that directs parties to the same goal, the parties work together instead of against one another and achieve a better result.

The term alliance agreement contains an inherent contradiction. The parties are purporting to agree to work to a common goal to eliminate legal conflict. They do this by entering into an alliance. However, the term alliance has no legal meaning outside international law and, consequently, is not legally enforceable. So, in a sense, the parties are saying they want to work together towards a goal to eliminate disputes but the agreement by which they do this is arguably not enforceable or, at least, not wholly enforceable since an agreement is only enforceable in some instances. For example, construction contracts are typically legally enforceable agreements. In other words, the alliance agreement contains elements of an "agreement to agree."

Alliance agreements only include the parties to the agreement. This includes the owner, project management company and large EPCM contracting houses for the major components of the project, such as the mine, pipeline, power plant, processing plant and upgrader.

Typically, there are a number of associated entities that are not parties to the alliance agreement even though they are legally tied to the project. These parties may include insurers, governments and suppliers of extensive services or very large components, which may run into the hundreds of millions of dollars.

The alliance agreement sets out the relationship within the alliance. This may include establishing intent to manage rather than avoid risk, setting out project goals, such as "breakthrough performance" or "best performance by all participants," and creating a governance structure for the project. The governance structure often provides for the establishment of an alliance board comprised of representatives of the parties to the alliance who make all decisions and stipulate these decisions are unanimous.

The agreement will often stipulate the parties are not to blame one another and, pursuant to this provision, it may set out a prospective release or waiver of all claims against one another.

The prospective release and waiver of claims is then typically modified to exclude:

- The failure of one party to pay another party in respect of work done; and/or
- A claim for contribution or indemnity resulting from a claim by a third party not part of the alliance against a party that is a part of the alliance.

Typically, there is also a provision that in the event of an inconsistency between the alliance agreement and the underlying EPCM agreements (which usually provide for provision of goods and services in return for payments), the alliance agreement will govern.

Repercussions

Typically, bonuses are provided for "breakthrough performance" and penalties are provided for failure to meet "stipulated goals."

If one of the parties to the alliance agreement does not substantially perform — be it the owner does not provide proper or timely guidance in respect of management of the project or one of the main EPCM contractors fails in a dramatic way to perform due to either external factors (the labour market) or internal factors (management failures) — the alliance agreement releases all claims (the "no blame" culture) but it also compels all parties to strive for a common goal ("breakthrough performance"). Legally, an obligation to strive for a goal is meaningless if there is no consequence for such breach.

Claims by third parties happen regularly on very large megaprojects. Third party claims by insurers can be particularly troublesome. Insurers are known to stand on their legal rights and are not particularly interested in the fact others have "agreed to agree" to strive to a common goal. Adjustment of claims, particularly when they are large, may be protracted and difficult and result in litigation or arbitration with the insurer. However, an alliance agreement eliminates an insurer's rights of recovery (subrogation).

A party to the alliance may have a substantial claim against a third party, such as a large subcontractor, supplier or insurer. Pursuit of this claim may require that evidence, either documentary or verbal, be provided by employees of other members of the alliance.

The goals of the alliance agreement — a cooperative, no blame culture leading to "breakthrough performance" — are laudable. However, parties should enter into these agreements with eyes open. Such agreements may be legally unenforceable, either in whole or in part. This lack of enforceability may lead to disappointment between the parties, which can lead to greater conflict and bitterness and even more difficult legal disputes. It may be better to have clear and legally enforceable contracts between the parties, which are administered by competent executives with practical business judgment. **CB**

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